UNITED NATIONS CONFERENCE
ON TRADE AND DEVELOPMENT

# GLOBALIZATION AND LIBERALIZATION

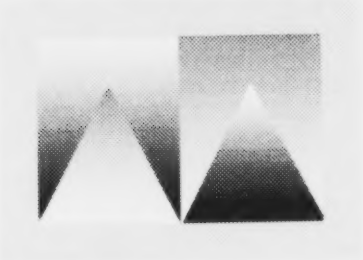
## Development in the face of two powerful currents

UNITED NATIONS

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Report of the Secretary-General of UNCTAD
to the ninth session of the Conference

# GLOBALIZATION AND LIBERALIZATION



## Development in the face of two powerful currents

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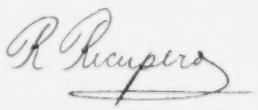
## FOREWORD

In submitting this report, I would ask the readers to regard it as one tage in a process of reflection which began in the UNCTAD secretariat be- ore I took office as Secretary-General and which I have joined and steered ince then. It therefore embodies our current state of thinking, and that hinking—particularly as it concerns the future work of the organization—is reliminary and tentative.

The report is thus a working document, offered as a contribution to an ngoing dialogue. I welcome comments and inputs—including critical nes—from governments, multilateral institutions, universities, the private ector and non-governmental organizations.

I believe such an open and dynamic approach is the most appropriate, nd perhaps efficacious, way of coming to grips with a rapidly and con- tantly changing world political and economic scene.

I should also like to point out that initially this foreword was to have ncluded my personal reflections on some of the issues I regard as crucial in lefining UNCTAD's work as we approach a new millennium. However, as I ompleted work on the foreword, it became apparent that these personal re- lections could make a contribution to the consideration by governments of he issues raised by item 8 (*d*) of the provisional agenda of UNCTAD IX, namely **Future work of UNCTAD in accordance with its mandate; insti- utional implications**. I have therefore included them in chapter IV of the eport.



RUBENS RICUPERO

*Secretary-General of UNCTAD*

## CONTENTS


Foreword

| *Chapter* | | *Paragraphs* |
|---|---|---|
| I. | TRADE AND DEVELOPMENT IN A LIBERALIZED AND GLOBALIZING WORLD ECONOMY | 1-135 |
| | A. Introduction | 1-2 |
| | B. Liberalization and a globalizing world economy | 3-21 |
| | 1. Liberalization and the broadening scope for private initiative | 3-14 |
| | 2. The globalizing world economy | 15-21 |
| | C. Liberalization, globalization and development | 22-108 |
| | 1. The role of the State | 22-32 |
| | (*a*) The State, enterprises and development in a globalizing economy | 22-24 |
| | (*b*) The State and the sustainability of development | 25-28 |
| | (*c*) The State and the distribution of economic benefits | 29-32 |
| | 2. Seizing the opportunities | 33-78 |
| | (*a*) Trading opportunities arising from the Uruguay Round | 34-62 |
| | (i) Trade policy implications | 43-53 |
| | (ii) Issues of trade efficiency | 54-62 |
| | (*b*) Opportunities related to international capital flows and the financing of development | 63-68 |
| | (*c*) Opportunities provided by international production | 69-73 |
| | (*d*) Globalization, liberalization and economic and technical cooperation among developing countries | 74-78 |
| | 3. Meeting the challenges | 79-108 |
| | (*a*) Loss of policy autonomy | 80-81 |
| | (*b*) Financial openness and the risk of instability and disruption to development | 82-90 |
| | (*c*) The phenomenon of marginalization | 91-108 |

| Chapter | | Paragraphs |
|---|---|---|
| | (i) Supply-side impediments | 92-93 |
| | (ii) Commodity dependence | 94-98 |
| | (iii) Difficulties in attracting FDI | 99 |
| | (iv) The decline in official development assistance (ODA) | 100-104 |
| | (v) Continued difficulties with external debt | 105-108 |
| | D. Managing a liberalized and globalizing world economy in the pursuit of growth and development | 109-130 |
| | 1. Globalization, interdependence and economic management | 110-114 |
| | 2. Evolving institutional, legal and regulatory frameworks | 115-130 |
| | (*a*) The international trading system: new and emerging issues | 115-120 |
| | (*b*) Current trends in the evolution of arrangements governing foreign direct investment | 121-125 |
| | (*c*) Current trends in the evolution of the regulatory framework for international financial flows | 126-130 |
| | E. Conclusions | 131-135 |
| II. | PROMOTING INTERNATIONAL TRADE AS AN INSTRUMENT FOR DEVELOPMENT IN THE POST-URUGUAY ROUND WORLD | 136-246 |
| | A. Opportunities and challenges for promoting economic growth and sustainable development | 140-145 |
| | B. Enhancing the participation of the developing countries and countries in transition in international trade: policy approaches and measures | 146-211 |
| | 1. Trade policy | 147-174 |
| | (*a*) Effective implementation of the Uruguay Round commitments and further liberalization | 147-155 |
| | (*b*) Measures to alleviate transitional costs | 156-160 |
| | (*c*) Measures to enhance the effectiveness of the generalized system of preferences (GSP) | 161-165 |
| | (*d*) Assistance to enhance the capacity of the developing countries and countries in transition to participate effectively in the WTO system of rights and obligations | 166-171 |
| | (*e*) Structural adjustment policies of developed countries | 172-174 |

Chapter | Paragraphs

2. Trade Efficiency ..... 175-188
(*a*) Establishing a Trade Efficiency Review Mechanism (TERM) ..... 177-180
(*b*) Providing the Global Information Infrastructure with a development dimension ..... 181-183
(*c*) The creation of subregional GII nodes ..... 184-188
3. Measures and actions to address commodity dependence ..... 189-211
(*a*) Reduction of the instability and risks faced by the commodity-export-dependent developing countries ..... 191-197
(*b*) Promotion of commodity diversification ..... 198-205
(*c*) The efficient management of natural resources 206-211

C. New and emerging issues ..... 212-241
1. Competition policy ..... 216-220
2. Trade and investment ..... 221-223
3. Trade and environment ..... 224-237
4. Regionalism and the new and emerging issues ..... 238-241

D. Promoting complementarity between UNCTAD and WTO ..... 242-246

III. PROMOTING ENTERPRISE DEVELOPMENT AND COMPETITIVENESS IN DEVELOPING COUNTRIES AND COUNTRIES IN TRANSITION

Introduction ..... 247-249

A. The enterprise sector in developing countries and economies in transition
1. Main features ..... 250-258
2. The East Asian experiences ..... 259-264

B. National and regional policies for enterprise development and competitiveness ..... 265-310
1. The enabling environment ..... 265-266
(*a*) Fostering business confidence and investment 267-271
(*b*) Strengthening government-business relationships ..... 272-275
2. Formulating national strategies for enterprise development ..... 276-310
(*a*) Elements of an enterprise development strategy ..... 277-310
(i) Mobilizing entrepreneurial resources ..... 279-281

Chapter | Paragraphs

(ii) Supporting micro-enterprises in the informal sector ..... 282-284
(iii) Assisting small and medium-size enterprises ..... 285
(iv) Access to support services ..... 286-289
(v) Access to finance ..... 290-294
(vi) Access to information networks ..... 295-296
(vii) Building technological capabilities at the enterprise level ..... 297-300
(viii) Encouraging inter-firm linkages ..... 301-305
(ix) Regional cooperation ..... 306-310

C. Facilitating enterprise operations in a global economy: the need for international action ..... 311-332

1. Global supporting activities ..... 312-327
(*a*) Fielding of enterprise development missions, especially in LDCs ..... 312-316
(*b*) Ensuring that structural adjustment programmes include strong measures in favour of enterprise development ..... 317-319
(*c*) Activities aimed at enhancing enterprise competitiveness ..... 320-325
(i) Capacity building for producer services ..... 320-321
(ii) Capacity building in trade efficiency ..... 322-324
(iii) Science, technology and innovation policy reviews ..... 325
(*d*) Diffusing "best support practices" for enterprise development ..... 326-327
2. Issues for intergovernmental action ..... 328-330
3. Establishment of a Global Advisory Committee ..... 331-332

IV. FUTURE WORK OF UNCTAD IN ACCORDANCE WITH ITS MANDATE: INSTITUTIONAL IMPLICATIONS—SOME PERSONAL REFLECTIONS ..... 333-355

*Chapter I*

# TRADE AND DEVELOPMENT IN A LIBERALIZED AND GLOBALIZING WORLD ECONOMY

## A. Introduction

1. The progress of development since UNCTAD VIII has been uneven. A number of developing countries, particularly in Asia, have sustained the high rates of growth already in place at the time of UNCTAD VIII, and some have been able to accelerate growth. Since the last Conference, Latin America has definitely emerged from the debt crisis that had weighed on economic performance in that region for a decade. However, in many of the poorer developing countries, especially those in Africa, progress has been modest. In many cases output has barely succeeded—or has not succeeded—in advancing at the same pace as population, and well-being has stagnated or, for some segments of the population, declined. Overall, the disparities in economic conditions among developing countries appear to have widened since UNCTAD VIII.

2. These broad trends have taken place against the background of rapid changes in the world economy—changes that can be described by the general concepts of liberalization and globalization. These changes, together with the growing recognition of the need to ensure that economic advance is sustainable, are altering the way the international economy operates and affecting the character of successful policy approaches to development. This report examines the opportunities for growth and sustainable development offered by the processes of liberalization and globalization, as well as the risks and potentially negative consequences for development that might flow from them, and discusses some of the policy approaches that would allow the opportunities to be fully grasped and the potentially negative consequences to be avoided or overcome.

## B. Liberalization and a globalizing world economy

### 1. Liberalization and the broadening scope for private initiative

3. During the past decade, liberalization has been the hallmark of economic policy throughout the world. Virtually all governments have taken

significant steps to widen the role of private enterprise in economic activity. In some countries—for example the former centrally-planned economies—this constituted a veritable change of regime. For others—for example a number of Latin American countries—it constituted a major shift in the philosophy and approach towards fostering development. In still others—for example some European economies—it constituted an adjustment of the role of government in a mixed economy.

4. A wide variety of specific types of measures has given effect to liberalization policies. In countries with economies in transition, the change of regime has required the disengagement of the State from production of goods and services across virtually the whole economy, and the establishment of the institutions and legal frameworks appropriate to the functioning of a market economy. In economies that relied mainly on private enterprise to organize production, the role of the State has been reduced and revamped. In both transition and market economies these moves have resulted in the privatization of State enterprises. In market economies there has also been extensive reduction in government regulations guiding private-sector activity, and some revamping of regulations to meet emerging needs, as in the areas of finance and environmental protection, while in most transition economies there is a need to put in place or strengthen regulatory regimes. In all countries, however, ensuring that prices are a true reflection of relative scarcities and giving freer rein to the energies of private enterprise were seen as essential ingredients of successful economic policy. This, in turn, reflected renewed emphasis on the role of privately-owned production units (firms, farms, cooperatives and family businesses) as the most effective and efficient means for organizing economic production.

5. In the developing world, liberalization has been taking place in a variety of circumstances. In the dynamic economies of East and South-East Asia, liberalization has in some cases been proceeding at a deliberate pace, with government measures to open markets to foreign competition and reduce support for the private sector being put in place gradually, as industries in the sectors in question acquired the necessary competitive strength in international markets. In other Asian countries, liberalization was more rapid. In all cases it took place against the background of high growth rates. In Africa, liberalization has tended to be more hesitant, while in Latin America it has generally gone forward at a brisk pace. In both Africa and Latin America liberalization has taken place as part of a policy response to low growth and, in some countries, financial crisis.

6. In all countries, external transactions have been a key component of liberalization strategies. This is because liberalization of international trade, investment and capital movements can improve allocative efficiency and can bring about greater dynamism in an economy, thus providing faster economic growth. Among the expected benefits of increased openness to trade

are the improvements in innovativeness and productivity of domestic firms due to external competition. Consumers also gain from the wider choice of goods and services and reduced prices resulting from increased international competition and specialization. Economies open to competition from abroad are also presumed to be better able to adjust to adverse external shocks, and less prone to wasteful rent-seeking. At the same time, the increased mobility of factors of production—especially capital and, with it, technology—can help a country overcome the dangers of being trapped by static comparative advantage and achieve the continued shifts in its resource endowments required for sustained economic growth and productivity gains. Further, liberalization of capital movements means that the link between domestic savings and domestic investment can be relaxed: that is, domestic investment need not be constrained by weak domestic saving behaviour and, conversely, high domestic savings should flow abroad to where they are demanded.

7. Liberalization has, however, proceeded at different speeds and in different ways as far as trade, investment and finance are concerned. Multilateral trade liberalization, a process that began with the establishment of GATT some 50 years ago, has taken a decisive step forward with the completion of the Uruguay Round, which has dramatically reduced tariffs and removed quota obstacles that traders encountered at the borders of all groups of countries; these reductions furthermore have been bound into multilateral contractual commitments with the possibility of recourse to workable dispute settlement mechanisms. While there are still a number of sectors where liberalization has been partial—including agriculture and textiles and clothing, which are of particular importance to developing countries—liberalization of international trade has progressed to an impressive extent.

8. Investment liberalization has proceeded in a much more uneven manner. While virtually all developed countries have liberalized their regimes for inward and outward foreign direct investment (FDI), especially over the past 30 years, most developing countries and those of Central and Eastern Europe have joined in this process only recently. Once convinced that FDI could play a positive role in promoting economic growth and technological progress, developing countries and countries of Central and Eastern Europe took substantial unilateral steps to liberalize their inward FDI regimes: between 1991 and 1994 alone, 368 out of 373 changes in national FDI regimes were in the direction of greater liberalization. As a rule, changes involved the tempering or removal of obstacles to foreign investors, the establishment of standards for their treatment, and the increased use of incentives to attract FDI, with some steps also taken to ensure the proper functioning of markets. Furthermore, these liberalization measures were generally accompanied by other measures aimed at improving the investment climate for TNCs, especially by granting better protection to foreign investors.

9. Such liberalization has been uneven, however, as far as sectoral coverage is concerned. The manufacturing sector is now open to inward FDI in most countries while such opening up has been much slower in natural resources and services—sectors in which even most developed countries maintain certain restrictions. And, as far as outward FDI is concerned, only a few developing countries have begun the liberalization process. Furthermore, the great bulk of liberalization measures have been taken unilaterally or in the context of regional integration efforts. They are not bound in a multilateral framework, although efforts are under way that could eventually lead to such a framework. Still, the overall trend is in the direction of greater liberalization, complementing therefore more and more the international trade regime in terms of creating a situation within which firms have the freedom to organize their activities across national boundaries.

10. The liberalization of trade and FDI regimes has been accompanied by a liberalization of financial transactions. In developed countries, since the early 1970s freedom of capital movement has been increasingly viewed as an important policy objective; and financial deregulation and liberalization have both accelerated during this decade. Financial liberalization is generally less advanced in developing countries, but the pace of change has been much more rapid. Inward investment by non-resident investors is virtually free in a number of developing countries. As for outward transactions, an increasing number of developing countries have adopted capital account convertibility in recent years. Liberalization of transactions in foreign currency among residents has gone much further. Indeed there has been a tendency to encourage residents to hold foreign exchange deposits with banks at home.

11. The recent growth of portfolio investment in developing countries has been accompanied by measures going beyond the obligations of IMF Article VIII, which requires liberalization of many current-account financial flows such as interest payments on loans and net income flows on other investments. These have included relaxations of restrictions on capital inflows, many of them embedded in regulations originally concerned more with restricting foreign ownership through FDI. At the same time capital repatriation has also been made much easier. Thus, for example, at the end of 1993 only seven of a sample of 33 developing countries and economies in transition classified as emerging markets by the International Finance Corporation (IFC) maintained restrictions on the repatriation of capital invested in equities.

12. The internationalization of portfolio equity investment involves not only transactions on stock markets by non-resident investors but also the buying and selling by investors on their local stock markets of the shares of foreign companies. The equities of many developing-country firms are now listed on stock exchanges in OECD countries, and there has been a rapid in-

crease in the trading of such securities since the beginning of the 1990s, especially those issued by Latin American entities.

13. Liberalization of trade and investment has been influenced by the expansion and intensification of regional integration efforts, which have continued even after the successful conclusion of the Uruguay Round and the establishment of the World Trade Organization (WTO). The weight of this factor is best measured by the fact that trade among the members of regional groupings already accounts for almost half of world trade. Beyond the recent launching of NAFTA, the enlargement of the EU and the implementation of its Association Agreements with some Central European countries, several other regional projects involving countries at different levels of development are in the making, including some embracing both developed and developing countries. Subregional integration among developing countries and various countries in transition is also making progress. There is an increased emphasis within groupings on the liberalization of investment and services and on technological cooperation, as well as on gradual harmonization of national policies with an impact on trade and investment. Increasingly, regional arrangements tend to include new spheres such as environment, competition, labour standards, the liberalization of regional labour markets and monetary integration. All of this reflects the desire by many governments to have a range of opportunities for pushing forward with liberalization, rather than relying solely on global multilateralism.

14. These developments are bound to affect the patterns of international trade, production and investment of both members and non-members of regional groupings. Most estimates concur that, overall, their trade-creation and dynamic-efficiency effects are likely to outweigh potential trade and investment diversion effects for third countries. However, for developing countries in particular, the emergence of economic groupings involving major trading nations has given rise to concern. Even if the results of the Uruguay Round should significantly reduce the risks of tariff-induced trade diversion by integration groupings, trade diversion effects may still be significant in certain sectors where tariffs remain high, which include sectors of interest to developing countries, notably agriculture and textiles, and in the area of government procurement. The trade-distorting impact of regional agreements may arise from measures such as restrictive rules of origin and regional standards, and from regional information networks.

## 2. The globalizing world economy

15. The liberalization policies referred to above have progressively enlarged the effective economic space available to producers and investors, fostering the process of globalization throughout a large part of the interna-

tional economy; that is, they have set in train a process whereby producers and investors increasingly behave as if the world economy consisted of a single market and production area with regional or national subsectors, rather than of a set of national economies linked by trade and investment flows. However, there is a marked difference between the degree of globalization as reflected in trade, FDI and international finance. Over the past ten years, the volume of international financial transactions and the integration of financial markets of both developed and developing countries into the global financial system has proceeded at a more rapid pace than has the worldwide integration of other markets. Moreover, a remarkable feature of the recent increase in international financial flows is the very fast growth of cross-border financial transactions (that is, all portfolio transactions between residents and non-residents) relative to total net capital flows among countries, including developing countries. A large proportion of these international portfolio transactions are short term, involving round-tripping of capital and very rapid reversal of asset positions. International trade and production have not expanded at the same rate as international financial transactions, but production by transnational corporations has grown faster than trade. More importantly, trade and the internationally integrated production of TNCs have acted both separately and in interplay with each other to increase interdependence of economies in terms of production activities, lending a qualitative dimension to globalization that distinguishes it from its earlier variants.

16. The principal driving force in the globalization process today is the search of both private and publicly-owned firms (and more generally, producers and asset holders) for profits worldwide. Their efforts are made possible or facilitated by advances in information technology and by decreasing transport and communication costs. To maintain or increase market share and maximize profits in a world economy with rapid technological change, converging consumer tastes and liberalized flows of goods, services, capital and technology across national boundaries, firms are pursuing strategies that allow them to exploit all available sources of competitive strength, combining their own, firm-specific assets with assets that are specific to particular locations. They minimize transaction costs and maximize efficiency and profits through appropriate choice of modes of international transactions and distribution of assets and of international production activity.

17. The most widely acknowledged factors promoting the globalization of both production and finance are the recent advances in information technology; technical progress that has led to a steady decline in the costs of international transportation of goods and people and of international communication; and technological progress in manufacturing which makes it feasible to decompose production processes. The scope of the international division of labour, as well as of international financial transactions, has consequently

been considerably widened. The sharp decline in international transport and communications costs and the possibility of decomposing production processes have not only made a vast number of goods and services which were formerly non-tradeables into tradeables, but have also accelerated the process of internationalization of production and of services. At the same time, the drop in the costs of international communications and recent progress in information technology have opened vast possibilities for international financial flows.

18. The use of foreign production units, implemented through FDI, was facilitated by advances in management science, which have considerably enhanced the ability of firms to develop management structures capable of dealing with several production units located at large distances around the globe. But perhaps the most important single factor permitting the rapid globalization of production has been the revolution in semi-conductor, microchip technology and its application in combination with technical advances in telecommunications. With the ability to transmit virtually unlimited amounts of data at very low costs, firms can easily diversify geographically the various stages of production without losing managerial control. This technology has thus allowed firms to move beyond economies of scale and to exploit economies of scope, or to combine large-scale production with particularized production for individual market requirements.

19. All these factors have also had a pronounced impact on the globalization of finance. They allow financial institutions to be instantly informed about conditions in markets around the world, as well as to perform the detailed calculations necessary to identify profit opportunities from the allocation of capital in different areas. Financial globalization is further reinforced by the considerable expansion of the financial and business media, and the growing acceptance of English as the *lingua franca* of international business.

20. Globalization is the product of liberalization. But it has also set in motion forces working to accelerate liberalization. As firms increasingly see transnational production as necessary for their competitiveness and profitability, they are exerting more and more pressures on governments to provide conditions that will allow them to operate worldwide. This involves not only further liberalization of international trade but also freedom of entry, right of establishment and national treatment, as well as freedom for international financial transactions, deregulation and privatization.

21. Macro-economic forces have, meanwhile, exerted other pressures on firms and governments. Slow growth of demand, stagnant wages and persistently high unemployment in the developed countries over the past 20 years have resulted in pressures from firms and workers that have influenced these

countries' policies. The slow growth of domestic demand and the related squeeze on profits in developed countries has led firms there to intensify their search for growth and profits in other markets; in so doing, they also apply pressure on their home governments to demand greater openness of foreign markets. On the other hand, the persistence of high unemployment combined with these same factors has increased the threat of protectionism and selectivity in the liberalization of international trade in these countries.

## C. Liberalization, globalization and development

### 1. The role of the State

#### (a) *The State, enterprises and development in a globalizing economy*

22. With market mechanisms now playing an increasingly important role in the development process, the role of government is progressively shifting towards providing an appropriate enabling environment for private enterprise, and facilitating and fostering the establishment and expansion of private business. This is not necessarily a passive or indirect role. A number of governments in both developed and developing countries have successfully pursued proactive policy interventions to influence the savings and investment rates; to promote the efficient functioning of markets; to improve access to international markets and the diffusion of technology; to promote core capacities in manufacturing and services; and to create the best possible conditions for the competitiveness of their firms. Such policies are particularly important for developing countries, where enterprises need to build up their capacities in order to participate fully and effectively in international markets and production. In these countries the promotion of small and medium-sized enterprises is often a particularly important component of government policies to foster development.

23. Thus, the shift towards reliance on market forces as the primary means for the allocation of resources and the organization of economic activity as a whole means a new, but not necessarily less relevant, role for the State in promoting development. Governments need to encourage entrepreneurship, to promote human resource development, to develop and maintain internationally oriented infrastructures, and to ensure the free flow of information. Governments also need to assist the main actors in the market—producers and consumers—to adapt to the demands of a more competitive market place, by facilitating training and the availability of enterprise-support services.

24. There is a growing recognition in nearly all countries that government interventions in the economic sphere which promote or perpetuate ''rent seeking'' should be strongly discouraged. At the same time, in view of the successful development and economic transformation experience of the East Asian countries, it is widely acknowledged that governments can pursue effective policies aimed at enhancing the capacity of their enterprises and corporations to meet international competition, and that they can adopt specific policy measures to increase domestic savings and investment rates. An important lesson learnt from the East Asian countries' experience is that policies used to increase the rate of capital accumulation can have as much influence on promoting technical change, international competitiveness and industrial development, as do export promotion and other policies more focused on individual sectors or industries.

(b) *The State and the sustainability of development*

25. Appropriate government policies or interventions may also be required to deal with market failures or deficiencies associated with the consistent inability of markets to deal with the phenomenon of externalities. An important example in this regard is the inability of markets to ensure on their own the environmental sustainability of economic activity. Markets and the associated accounting systems (market prices) often fail to recognize natural resources, which notably include all environmental resources, as assets, or to value properly resource-based goods and services, or the costs and benefits associated with external effects of production and consumption activities. In the absence of government intervention, and well-defined property rights for public goods, or goods to which access is generally open, such as clean water, clean air, bio-diversity, etc., those environmental assets tend to be treated as free goods in the economic production process and consequently over-used in production activities. In these cases, especially where the sustainability of environmental services is endangered, there is a clear need for governments to intervene in order to create the conditions for the internalization of those external costs associated with such over-use. However, in order to avoid creating excessive rents, government intervention should rely to the greatest extent possible on market-related instruments for internalization of external costs and benefits.

26. It may be noted, however, that in some cases government intervention has worsened the situation, for example by underpricing certain resources either by providing them below their marginal cost or by subsidizing private producers. Thus, prices of water, energy, pesticides and fertilizers are frequently set at less than their marginal cost to society and, in certain cases, at even less than the private marginal cost of production. Governments intervene in agricultural commodity markets through price support, agricultural

taxation and export taxes. Whereas in the developed countries, intervention usually seeks to keep domestic agricultural prices above world market levels, in the developing countries, agricultural production is often influenced by interventions to keep domestic agricultural prices below world price levels. Both types of intervention have adverse consequences—both static and dynamic—for the management of natural resources: resources are misallocated and prematurely depleted, to the detriment of future generations.

27. Distortions affecting the management of natural resources do not arise solely from policies directed to the natural resource sectors. Policies which promote industrialization at the expense of agriculture discourage investments in land conservation and encourage encroachment on marginal lands. Certain trade policies can also create problems: agricultural protectionism leads to more resources being used in farming than is environmentally or economically justified and impedes market access for low-cost producers, thus raising consumer prices in developed countries while lowering incomes in developing countries.

28. The lessons of this experience are twofold: first, the market system by itself sometimes provides incorrect signals and misleading information and therefore needs to be complemented by necessary government intervention; secondly, such government intervention should seek to ensure that levels of benefits and costs reflect the fullest information about scarcity and price, rights and responsibilities, actions and consequences. The use of such information by society is a necessary precondition for an effective human interface with the natural environment and for the promotion of sound management of natural resources and sustainable development. Non-governmental organizations can play a positive role in this regard.

(c) *The State and the distribution of economic benefits*

29. Government also has an increased role to play in combating the unwanted accompaniments of liberalization and globalization. In particular, there is a need for public policy to address issues related to poverty and income distribution. Many economic actors, such as poor and vulnerable groups, are unable to seize market opportunities to achieve even minimum income levels. To assist these groups to gain access to, and to exploit, market opportunities, governments have a critical role to play in promoting social human development and in providing the poor with the necessary working skills. Adequate safety-net provisions for the unemployed are also important.

30. Many industrialized countries, however, have been searching for ways to slow down or roll back the impact of the growth of employers' social se-

curity contributions on labour costs, with consequent implications for the well-being of the vulnerable and unemployed. One reason for this has been the desire to make wages more competitive with those prevailing in other countries. But there have also been broader concerns leading to the need to reform social security. These included the mounting costs associated with population ageing, changing family structures, ever more expensive medical care, persistent unemployment and public concern over the abuses and disincentive effects of social welfare. These factors, together with the constraints of slow economic growth and the maturation of pension schemes with respect to funding have led to spiralling costs of social security systems.

31. One of the main social challenges that developed countries have had to face in a more competitive world has been how to deal with low-skilled workers endowed with only limited potential or will to increase their skills. Although jobs exist in non-tradeable activities, the pay and job security are generally not attractive. In the production of tradeables, such workers run the risk of being marginalized, since unless training and retraining activities are put in place to enable them to enhance their skill levels, unskilled workers in developing countries can often do the same work at much lower cost.

32. Budgetary cutbacks in social services have also occurred in many developing countries, in particular in Africa and Latin America. Following the reductions initiated in the early 1980s as part of the stabilization and adjustment measures to cope with the foreign debt crisis in most countries in those regions, the levels of social service funding per capita, adjusted for inflation, still generally remain below the levels attained in the 1970s. Both quality and, to a lesser extent, coverage have declined as a result. In some countries, already inadequate social infrastructure, in areas such as health and education, has likewise deteriorated.

## 2. Seizing the opportunities

33. The processes of liberalization and globalization referred to above open up new opportunities for development. The successful completion of the Uruguay Round promises to expand the effective scope of world markets available to exporters and potential exporters in developing countries. The growing flow of foreign direct investment is offering greater opportunities to secure investment finance from abroad, but also—sometimes more importantly—to secure access to the technology, skills and management practices essential to development. And the sharp growth of flows of portfolio capital enlarges considerably the possibilities for firms to secure their own financial needs through capital markets on attractive terms. Opportunities thus exist which, if grasped adroitly, can add new momentum to the development process.

(a) *Trading opportunities arising from the Uruguay Round*

34. The UNCTAD secretariat has undertaken an initial assessment of the outcome of the Uruguay Round with emphasis on the interests and concerns of developing countries and on the new trading opportunities resulting from the implementation of the Agreements. The analysis has concluded that the outcome of the Uruguay Round does indeed open up important trading opportunities. They stem, to begin with, from the significant tariff cuts which have been achieved. In major industrial countries, duty-free access for products will increase from 20 to 43 per cent of total imports, and the trade-weighted average tariff on imports of industrial products from all sources will be reduced by 40 per cent, from 6.3 per cent to 3.7 per cent. On imports from developing countries, the reduction in the average tariff will be somewhat smaller—30 per cent.

35. New trading opportunities stem also from the fact that the Uruguay Round effectively addressed areas and sectors where, until then, the absence of international consensus and workable rules had given rise to discriminatory protective measures and trade tensions. This refers particularly to the Agreements on safeguards, subsidies and countervailing measures, agriculture, and textiles and clothing.

36. The Agreement on Safeguards specifically prohibits voluntary export restraints (VERs) and other "grey area" measures, which are to be phased out over a period of four years, thus dealing with a major element in the erosion of the multilateral trading system. The Agreement on Subsidies and Countervailing Measures for the first time defines a subsidy, and reflects a consensus as to the appropriate role for governments in supporting production and trade.

37. The Agreement on Textiles and Clothing provides for the phasing out of the Multifibre Agreement (MFA) with its discriminatory and restrictive regime. The MFA distorted world trade in textiles for over three decades, and penalized developing countries in particular. The new Agreement involves the integration of the textiles and clothing sector into the GATT/WTO multilateral rules and disciplines over a period of 10 years, supplemented by a progressive expansion of quotas during the transitional period.

38. The Agreement on Agriculture converts virtually all the non-tariff barriers to tariff-based protection, and includes a reduction by 36 per cent in the resultant and other agricultural tariffs, on a simple basis, in developed countries (with a minimum reduction of 15 per cent per tariff line) and by 24 per cent in developing countries. It also requires reductions in export subsidies and in domestic support to agricultural producers. The Agreement is a major

step towards a market-based world agricultural economy. In addition, the agreements on clarifying technical issues related to sanitary and phytosanitary regulations, technical standards, customs valuations, import licensing and pre-shipment inspection should reduce the risk of their being used as protectionist devices.

39. Also conducive to increased trading opportunities is the extension of multilateral disciplines to trade in services. The General Agreement on Trade in Services (GATS) will provide a framework for a more secure and open market in services in a similar manner as the GATT has done for trade in goods. Its scope is impressive, covering such diverse aspects as investment, movement of persons and professional qualifications, and movement of electronic data across national frontiers. It provides a negotiating framework which permits developing countries to obtain reciprocal concessions in sectors of interest to them, including access to technology in return for opening their markets to trade and investment in services of interest to the developed countries.

40. The internationalization of services, combined with the liberalization of trade in services, should enhance the ability of developing countries to develop efficient producer services. These, given the rising service intensity of production, are acquiring increasing importance for the competitiveness of the whole economy. They facilitate the application of new management techniques, make relations between various stages of design, production and marketing of products and services more expeditious, allow customized services to appear, help to generate greater economies of scale and facilitate an efficient globalization of the production and distribution functions. There are also greater opportunities for the export of labour-intensive services through information networks. The effective implementation of the development-oriented provisions of the GATS would create opportunities for developing countries to increase their exports of services, which would be an essential element in their integration into the world trading system.

41. All the above new trading opportunities have emerged in the context of a greatly strengthened multilateral system of rules and disciplines embodied in the World Trade Organization (WTO). All WTO members must accept all of the component multilateral trade agreements, and the multilateral rights and obligations of all countries have been raised to broadly comparable levels. The various agreements have been linked together within the formal institutional framework of WTO through a common and much improved system for the settlement of disputes. The outcome of the Uruguay Round has also served to dilute many of the discriminatory aspects of regional trade agreements, by reducing tariff preferences for regional partners and often establishing multilateral disciplines of equal or greater stringency than those in regional agreements. While there has been a dramatic increase

in the multilateral obligations of most developing countries, differential and more favourable treatment in their favour is now established in a contractual manner, thus providing them with further security and predictability.

42. However, there are difficulties facing the actual translation of the commitments made in the Uruguay Round Agreements into concrete trading opportunities. Some of the agreements leave a margin of interpretation that could allow the reintroduction of protectionist measures. Moreover, developing countries and economies in transition often face constraints on taking full advantage of the trading opportunities created. The issues concerned can be considered under two headings: those that relate to trade policy, and those that relate to trade efficiency.

(i) *Trade policy implications*

43. A number of features of the results of the Uruguay Round can be constraining factors for developing countries' efforts to take full advantage of the trading opportunities. Also, countries in transition face special problems which could severely limit their ability to benefit from the multilateral trade liberalization.

44. Tariff reductions for industrial products, significant as they are, do not cover all dutiable imports in the markets of the major developed countries. Moreover, virtually no reduction was offered on the 22 per cent of dutiable imports which were deemed "sensitive". These include products of particular export interest to developing countries such as items in the leather, rubber, footwear and travel goods category. In addition, a relatively high degree of tariff escalation will persist in most product groups, particularly those of export interest to developing countries. These include tropical and natural resource-based products.

45. Constraints on the ability of developing countries to take full advantage of trading opportunities in the textile and clothing and agricultural sectors derive from the considerable latitude which countries have in the implementation of their commitments. The "end-loading" feature of the Agreement on Textiles and Clothing, in conjunction with the "integration" choices of governments, could postpone the realization of new market opportunities until the end of the ten-year implementation period. Additionally, the possibility of recourse to the transitional safeguard provisions, which permit new quantitative restrictions to be imposed on a discriminatory basis for up to three years, including against countries and products which were not restrained under the MFA, could in fact reduce export opportunities in the short run.

46. Under the Agreement on Agriculture, governments have a degree of flexibility in the implementation of their commitments on market access, export subsidies and domestic farm support which could reduce potential trading opportunities. The tariffication process has resulted in very high levels of tariffs on affected products, the protective effect of which is supplemented by the Special Safeguard Clause, which permits additional duties on imports of those items subject to tariffication if imports of a given product exceed a ''trigger price'' or ''trigger volume''. Tariff quotas, which are provided at lower rates to implement current and minimum access commitments, may represent the only real market opportunities created by the Agreement. The arrangements which importing countries adopt to allocate quotas among countries will have a significant bearing on trading opportunities actually created.

47. With regard to export subsidies, reduction commitments have been established for broad product groups rather than at the individual product level. There is therefore an element of uncertainty as to how the overall commitment will affect specific products. Furthermore, since there is no restriction on how the remaining allowable subsidies can be used across markets, it will again be a matter of policy to decide in which markets subsidized exports will actually be reduced, or whether a sequential targeting of markets would not occur. Concerning domestic support, as AMS (Aggregate Measurement of Support) reduction commitments are sector-wide, countries have considerable flexibility with respect to product-specific action.

48. The Agreement of Safeguards contains provisions which provide for the possibility of negotiating quotas with supplying countries, as well as for countries' deviation from strict MFN treatment (''quota modulation'') where there has been a ''disproportionate increase'' of imports from certain supplying countries. The Agreement did not include provisions on ''circumvention'', which introduced an element of uncertainty.

49. In the GATS there is considerable imbalance as to the extent to which different sectors or modes of supply have been made subject to specific commitments in the schedules. Most offers only provide a standstill in a wide range of sectors. Moreover, some developed countries have entered far-reaching MFN exemptions on some important services sectors. The mode of supply most frequently found is commercial presence. Few developing countries, however, are in a position to benefit from this mode of supply, given the high cost of establishment in developed countries and the weakness of the developing-country firms in terms of financial and human capital and access to distribution networks and information channels and technology. Thus, the immediate major beneficiaries of the GATS are those transnational service enterprises which are able to establish a commercial presence elsewhere. The mode of supply in the form of movement of natural

persons, on the other hand, is mainly bound through horizontal commitments without sectoral specificity. A few countries have offered access to specialty occupations and contract-related professionals.

50. The trade-policy implications of the trading opportunities offered by the Uruguay Round are, of course, closely intertwined with issues concerning the export supply and market capabilities of developing countries. Internal conditions in those countries, especially in the least developed countries and other structurally weaker economies such as those in Africa, may place constraints on their ability to take full advantage of trading opportunities. Most developing countries do not possess internationally competitive production bases. Equally constraining is the limited capacity of economic actors in these countries to identify new comparative advantage niches, to mobilize the necessary investment and marketing resources and to contend successfully in a highly competitive global market, especially in areas where trade preferences have been reduced. In some cases, the task of developing these sectors and capacities is handicapped by the lack of an enabling policy and institutional environment. These problems are further exacerbated in the case of countries which are heavily commodity-dependent—an issue which is taken up in section 3 (*c*) (ii) below.

51. The difficult situation of these countries is further exacerbated by a partial, or in some cases total, erosion of preferential tariff margins enjoyed by a large number of developing countries under the GSP and other preferential trade arrangements such as the Lomé Convention and the Caribbean Basin Initiative as a result of the Uruguay Round tariff reductions. Without the price advantages which allowed those countries to compete more effectively with imports from non-preference-receiving countries, some of them may not be able to maintain their market shares.

52. Countries in transition face a special situation. Many of these countries have not yet fully adapted their economic institutions and policies so as to be able to pursue trade-oriented growth strategies. Most of them, moreover, are not WTO members and did not participate in the Uruguay Round. Almost all of the non-members have initiated WTO accession procedures, but in most cases the process is only at an early stage.

53. Finally, the economies in transition still face a number of ''residual'' restrictive elements in the trade regimes of major developed countries. Although in recent years the latter have taken measures at the bilateral and regional levels to open their markets to countries in transition, in particular by eliminating or liberalizing quantitative restrictions and extending the benefits of GSP treatment to those countries, countries in transition are still subject to selective non-tariff measures applied against their exports, including selective safeguards and special anti-dumping duties.

(ii) *Issues of trade efficiency*

54. It has been estimated that the cost of trading procedures represents at least 10 per cent of the total value of international trade. Thus, efficiency in the conduct of international trade transactions (i.e., reduction in the costs of international transactions), as well as access to global trade-related information flows and networks, have become increasingly important factors for countries and firms to enhance their participation in international trade and to seize trading opportunities arising from trade liberalization. In most countries, failure to reduce such costs results in lost trade opportunities, reduced government revenues from trade, and lower international competitiveness. As modern management techniques linked to outsourcing and "just-in-time" production and delivery continue to spread worldwide, inefficient trade procedures and business practices lead almost inevitably to a country's inability to take full advantage of trading opportunities.

55. From the point of view of the international community as a whole, the broader adoption of efficient business practices is vitally important, since it is a necessary element in the facilitation and cost-minimizing of global trade. One particularly important case is that of Electronic Data Interchange (EDI), which has the potential to contribute to cheaper, safer and faster exchange of trade-related documentation, but will not generate its full potential benefits in the absence of universally accepted norms and standards. At the same time, those enterprises which have not adopted EDI may find themselves severely handicapped in entering certain markets. This is of particular concern for SMEs (especially those that depend on subcontracts from larger firms), and for developing countries.

56. In developing countries, especially the least developed ones, capacities for reducing transaction costs and for accessing trade-related information flows are generally limited, which is a major constraint on their ability to derive adequate benefits from globalization. In preparing for the United Nations International Symposium on Trade Efficiency held in Columbus, Ohio, in October 1994, UNCTAD, in cooperation with relevant international institutions, formulated a large number of practical measures that could significantly reduce the cost of international transactions and allow weaker participants in international trade to take greater advantage of trading opportunities arising from the twin processes of globalization and liberalization. These measures (annexed to the Columbus Ministerial Declaration) concern six areas: trade facilitation/better business practices, customs procedures, financial services, transport, telecommunications, and business information.

57. In many developing countries, inefficient customs procedures often constitute a major constraint on their participation in international trade. With the rapid spread of modern trading techniques, especially in the area of

electronic commerce, such constraints are rapidly becoming even more severe handicaps and a cause of exclusion.

58. Regarding trade-related financial services, in the absence of local capabilities in many developing countries, traders must rely on external suppliers of these services, most of whom are large banks and insurers based in developed countries. But SMEs are rarely among the clientele of foreign financial institutions and are therefore deprived of access to global network-based services (such as those of the Society for Worldwide Interbank Financial Telecommunications, SWIFT). Until now, no international instrument has been designed to assist SMEs to access financial services abroad.

59. New technologies have vastly increased the amount and variety of available business information and drastically reduced its cost. But inequalities of access to information and information networks continue to be a factor that prevents millions of traders from realizing their competitive advantages. While merchandise trade has benefited from the adoption of international standards at various stages of commercial transactions, no equivalent exists for the exchange of business information. However, the use of standards is a fundamental requisite for an efficient use of information technologies. Business information mostly tends to flow to and from developed countries. Developing countries are for the most part passive recipients rather than active sources of business information, even of that directly concerning them. A truly global trade system requires trade information flows that do not bypass the majority of the world's population. Efforts are needed in the standardization of business information and in the closing of existing gaps in its availability, both in terms of physical access and of cost.

60. The technical and economic evolution of international transport imposes further constraints on developing countries' ability to use international trade as an instrument for their economic development. Transportation services are becoming increasingly multimodal, involving a wide range of network and distribution channels. Many developing countries have difficulty in developing these services for lack of suitable physical infrastructure, such as seaports, airports, roads, or rail lines. The growing general use of management techniques such as "hubs and spokes" has led progressively to the disappearance (or higher cost) of "thin lines" in international transport. At the same time, the transport industry is being affected by massive concentration on the supply side, as well as on the demand side, where huge transnational companies have increasingly globalized their transport requirements through global carriage contracts with ocean carriers.

61. It should be emphasized, however, that the increasing impact of information technologies on the modalities of international trade also offers important opportunities for developing countries and their integration in inter-

national trade. Among others, it opens up possibilities to diversify away from their traditional array of exports (commodities, labour, transport and tourism), and it even alters their capacity to generate revenues from such traditional exports. Moreover, availability of mobile and affordable information technologies is affecting the fundamental mechanisms through which wealth is created and distributed, with immediate and significant impact on trade, growth and employment. While the importance of information keeps increasing as a strategic factor in international competition, its price has lowered dramatically and its ease of use has increased exponentially. For developing countries, which are generally affected by lower endowments in technologies and capital, this is both an additional obstacle to integration in global trade and an unprecedented opportunity to "leapfrog" to some of the most advanced segments of production and trade.

62. As the strategic role of information as a factor of trade competitiveness becomes more obvious every day, it also becomes clear that technology is only one condition of access to relevant information. Of equal importance will be the building up of local capacities to use and manage such information, which will require the production and development of interfaces, software and systems adapted to local needs and constraints (e.g. languages), and the diffusion of "generic" (as opposed to hardware-specific) knowledge through suitable training programmes. However, appropriate attention needs to be paid to ensuring that poorer economies have access to external providers of information: this will require the setting up of truly decentralized and global information systems with a clear focus on trade and development. The development of the Global Trade Point Network, discussed in the next chapter, is a concrete way of addressing this issue.

### (b) *Opportunities related to international capital flows and the financing of development*

63. Increased access to international financial markets is a source of both opportunities and risks. The opportunities relate to additional external financing for development, thus allowing domestic investment to exceed domestic savings. External financial transactions also allow greater flexibility in the financial management of firms. The risks result from the problems to government's macro-economic policy posed by surges of external financing, and from the volatility of some categories of external portfolio investment (see section 3 (*b*) below).

64. Historically, foreign private capital has in many cases played an important role in supporting the development process. This was true both in the nineteenth and early twentieth centuries for certain now developed countries, and more recently for a number of developing countries, principally in

Asia but also in Latin America. Most of this capital was in the form of external bonds, direct investment, and (in the more recent historical experience) medium- and long-term bank loans. External portfolio equity investment in developing countries on a substantial scale is a phenomenon of the last few years.

65. The increased flexibility associated with access to private financial markets (which must, of course, be exercised so as to sustain confidence and creditworthiness) not only gives rise to additional loosening of the link between national savings and domestic investment, but for some countries also loosens the link between public-sector revenue and expenditures. Even for developing countries that do not benefit from access to private external financing these links may not be rigid since most are recipients of bilateral and multilateral ODA. Nevertheless, the agreements upon which ODA flows are based are generally incapable of being adapted to the full range of the financing needs of, and investment opportunities in, recipient countries. Many of these needs and opportunities can be met only, or much more easily, by private sources of external financing.

66. Flexibility in firms' financial management is facilitated by access to external financing. This applies both to domestically-owned firms and to units or affiliates of transnational corporations. The flexibility results from the greater range of financing instruments available to firms with such access, and from the ancillary services which are typically supplied by banks and other financial institutions in international financial markets. Since access to external financing is closely connected to creditworthiness, it is also generally accompanied by lower transaction costs, owing to the influence which creditworthiness has on charges and insurance premiums for payments and financing arrangements in international trade and investment.

67. The expansion in private external financing for developing countries since the beginning of the 1990s has been concentrated partly on countries which largely or completely avoided being affected by the debt crisis of the 1980s (principally in Asia), and partly on countries in Latin America whose access to international capital markets was severely restricted during this period, but regained lender confidence following changes in government policies and underlying macro-economic conditions. Asian borrowers were the main recipients among developing countries of loans from banks in the 1980s; and seven countries from this region accounted for a large share of bank lending to developing countries in 1992-1994. In the case of external bond issues, the main recipients were the same group of Asian countries and four from Latin America. Similarly international equity issues have emanated from a limited group of Asian countries (which includes the main recipients of external bond and bank financing) and of Latin American countries. High degrees of concentration have also characterized external debt

financing in forms such as medium-term Euronote facilities and Eurocommercial paper. FDI flows are influenced by particularities of countries (such as the possession of natural resources) which are not necessarily correlated with access to external bank financing and portfolio investment. However, even here flows have been fairly concentrated, the main recipients including the Asian and Latin American countries already mentioned.

68. A few developing countries not belonging to these groups have also recently raised money in the form of external bond issues or syndicated medium- or long-term international bank loans, either for the first time or after a long absence from international financial markets. However, there continues to be a segmentation of developing countries by lenders with respect to access to private external financing. The great majority not only lack such access, but also, owing to unfavourable perceptions of their creditworthiness, face high costs for short-term financing, payments and insurance in their international trade.

### (c) *Opportunities provided by international production*

69. International production—including production by transnational corporation (TNC) parent firms, their foreign affiliates, and other firms related to TNCs through non-equity agreements and alliances—is also a potent source of opportunities for growth and development. It can bring together a mobile package of assets, including capital, technology, and technological and managerial capacities and skills, as well as the locational assets of host or home economies, to generate goods and services. The components of the package provided by TNCs constitute important resources and assets that could strengthen growth and development in the countries concerned. One of them is capital to finance investment. Foreign direct investment (FDI) is becoming an increasingly important component of long-term net resource flows to developing countries. During 1985-1992, the ratio of FDI flows to gross fixed capital formation in developing countries increased from 2 per cent to 7 per cent, a share higher than that in developed countries. To be sure, the actual increase in the direct contribution of FDI to capital formation is less than is suggested by these figures, since a certain proportion of FDI takes the form of purchases by foreigners of existing assets. Nevertheless, the role of FDI in capital formation in developing countries has undoubtedly grown, and appears set to continue to do so.

70. International production can also be an important source of opportunities for countries to strengthen their technological and organizational capacities and human resource capabilities. These capacities and capabilities, which determine the way in which tangible and intangible resources are converted into intermediate and finished goods and services, are generally

agreed to be the key determinants of economic progress for countries today. For developing countries, the potential opportunities offered by international production in this respect are particularly important: technological and organizational capacities are still highly concentrated in the developed countries and most developing countries must rely on foreign sources for the technology they need for rapid growth. Among these foreign sources, TNCs are particularly important, accounting as they do for an estimated three fourths of civilian R & D undertaken in market economies. The production and R & D activities of these firms (as well as their international trade) are thus important vehicles for the dissemination of technology, capacities and skills. They also provide opportunities for host and home countries to add to the technologies they possess and control and to their capacities for further technological progress. The success with which these opportunities can be realized depends on countries' abilities to attract FDI, to ensure that it carries the necessary technological and organizational components, and to exploit the latter through domestic efforts geared to learning and wider dissemination of the knowledge, capabilities and skills that international production brings with it.

71. In addition to the opportunities for accessing resources and strengthening technological and organizational capabilities and skills, international production can enhance the opportunities for countries to reach markets and expand trade. The role of international production in the exploitation and marketing of primary commodities has traditionally been significant. Over the past few decades, many developing countries have developed indigenous capabilities to finance, exploit, process and market their natural resources and raw materials; but for many others, the resources, and particularly the marketing links of TNCs, continue to provide important opportunities for developing resource-based activities. More importantly, the trend towards integrated international production in manufacturing and services provides opportunities for developing host countries to expand trade in goods and in services in which they have—or can rapidly acquire—comparative advantage. For some, these opportunities may, at least initially, take the form of integration into the international networks of TNCs that pursue simple integration or outsourcing strategies, through the provision of low-cost, labour-intensive inputs or products. For others, the opportunities could be more diverse and involve more sophisticated activities, as they exploit their competitiveness as locations for the establishment of functional components in the production chains of TNCs that organize their international production in a more complex fashion.

72. It should, however, be recognized that the countries which had initial conditions better able to serve TNC infrastructural, skill and market needs have, with time, become increasingly attractive for inward FDI, whereas those countries that did not meet those conditions initially have difficulty in

attracting inward FDI. The dynamics of this situation, unless countered by appropriate policy measures, will aggravate cross-country disparities in economic growth, infrastructure, skill and human resources development, as well as access to technology. Moreover, as more countries liberalize their FDI regimes, they are converging towards common standards which, in general, cover the right of establishment; fair and equitable treatment, including non-discrimination in the application of the law; protection against nationalization (except under clearly defined conditions), and standards of payment of compensation; international dispute settlement, including arbitration; and assurances for the repatriation of earnings and capital.

73. With FDI regimes converging, the appeal of any host country to potential investors is increasingly determined by other factors such as the macroeconomic environment, physical infrastructure and human resources. Government policies to affect these positively are therefore crucial.

### (d) *Globalization, liberalization and economic and technical cooperation among developing countries*

74. In a globalizing and liberalizing world economy, economic cooperation among developing countries (ECDC) is seen not only as an important component of an international strategy for promoting sustainable development, but as an instrument in itself for promoting the integration of developing countries into the world economy. It is now increasingly recognized that for ECDC to fulfil these twin objectives, it will need to evolve towards an open and flexible process—a process that emphasizes open membership; adopts international norms for the working of integration groupings; emphasizes harmonization of open and sound macro-economic policies of member States; and allows flexible arrangements among interested countries. In that process, technical cooperation among developing countries (TCDC) has an important role to play.

75. This new ''open and flexible ECDC'' has served to channel cooperative efforts into what may be described as ''viable economic spaces''. The rise of geographically non-specific groupings (e.g. the Group of Fifteen), of groups of countries at different levels of development (e.g. NAFTA and APEC) and of subregional partners with specific interests (e.g. MERCOSUR, COMESA, SARC, UMA and GCC) are all examples from the various regions of this new paradigm of cooperation.

76. In this context, the ECDC process is increasingly contributing through its own dynamics to the global economy. As noted at the Fifth Summit Meeting of the Group of Fifteen, the emergence of new and dynamic economic groupings in the South representing alternative economic centres can

serve as a powerful engine to boost South-South cooperation in such areas as trade, transport, telecommunications, exchange of information and technology, technical expertise and infrastructural development.

77. The strategy of ECDC in the context of globalization and liberalization must not only be open and flexible but should also emphasize the exchange of experiences as a means of learning from successful examples, whether these be regional or interregional experiences. Transmitting such experiences requires TCDC, the funding of specific cooperation projects by traditional donors, and global institutional support. The first two objectives can be met through tripartite arrangements in which developed countries provide financial support to the exchange of expertise and technical assistance among developing countries. Some developed countries have shown marked interest in this type of triangular cooperation. In practice, the exchange of experiences often has to involve governmental representatives and private-sector actors from developing countries.

78. The conclusion of the Uruguay Round provides a good opportunity for developing countries to reflect on the implications of the Round for ECDC. The ECDC process and the new rules may be seen as mutually reinforcing: they will enable cooperative groupings to use "open and flexible" ECDC to take maximum advantage of the new trading opportunities, as well as to serve as focal points for collaboration to obtain optimal results from the new institutional instruments of the multilateral trading system.

### 3. Meeting the challenges

79. The processes of globalization and liberalization can also give rise to a number of potential negative consequences and challenges to development. Some of the more important of these are: the loss of policy autonomy in some areas at the national level which restricts or alters the scope of development policies; the risk of instability and disruptions resulting from financial openness; and the risk of marginalization.

#### (a) *Loss of policy autonomy*

80. The economic liberalization policies being implemented in most developing countries, and consolidated in more stringent multilateral disciplines, have the effect of narrowing the policy instruments available to these countries. Specifically, the Uruguay Round Agreements involve an element of limitation of the range of policy options available. For example, developing countries may not be able to emulate the industrial policies previously followed by the successful developing countries in East Asia, in particular with

respect to measures aimed at increasing the competitiveness of industry and exports such as export subsidies, investment performance requirements and compulsory licensing. (It is fair, however, to say that the ultimate benefits of such policies have always been the subject of controversy.) Differential and more favourable treatment for developing countries has largely been limited to the granting of longer periods for implementing obligations applicable to all countries, although some agreements provide for more favourable thresholds for undertaking certain commitments.

81. Loss of policy autonomy does not arise only, and perhaps even mainly, from the obligations countries undertake in international agreements. Increased financial openness and the dismantling of barriers to capital flows have considerably strengthened the links between the financial markets of national economies, reducing the ability of national governments to use macro-economic policy instruments to influence objectives such as the volume of output, the level of employment and the rate of inflation. As is now well established, it is no longer possible to delink national interest rates from those abroad without suffering large amounts of capital flows and sharp swings in the external value of the currency. Nor is it always possible to pursue expansionary macro-economic policies regardless of the pace of demand abroad, because that would lead to a deterioration in the payments position. Attempts to check the leakage of demand and jobs through depreciations will tend to increase the import of inflation, whereas a greater emphasis on exchange rate and price stability will tend to make it more difficult to generate home employment. Such difficulties faced by a single country in attaining a high level of employment and price stability can give rise to pressures for protectionism and competitive devaluations.

### (b) *Financial openness and the risk of instability and disruption to development*

82. As many countries in Asia and Latin America are progressively integrated into the global network of financial markets, they have experienced not only sharp increases in capital inflows but also occurrences of volatility, owing to abrupt shifts in the sentiments of external investors. These inflows have become the subject of a new focus of concern among policy makers. While long-term foreign investment responding to a country's fundamentals is welcomed, policy makers are now much more aware of the problems that can be associated with large surges in inflows of portfolio capital. These problems are due not only to the volatility of much external portfolio investment but also to the challenge which large and unexpected inflows can pose to macro-economic management.

83. Surges in capital inflows are usually erratic and present the authorities concerned with difficult dilemmas. When they are on a large scale they usually imply some loss of influence by the authorities over domestic interest rates, exchange rates, or both. This makes adherence to macro-economic policy goals more difficult, and risks creating doubts in the minds of private-sector investors about the capacity of the authorities to maintain a stable, predictable macro-economic environment. Moreover, when the capital surge is prolonged, the strong upward pressure it will exert on the recipient's real exchange rate will have negative consequences for the competitiveness of exporters and import-competitors, thereby weakening further the current account and contributing to a situation in which at some point private investors could, usually correctly, judge the inflows to be unsustainable.

84. When external deficits can no longer be sustained because of a slowdown or reversal of capital flows, a sharp depreciation of the currency often becomes inevitable in order to undertake external adjustment, thereby creating inflationary pressures. Moreover, since it is not always possible to attain the required reduction in the external deficit by an increase in exports alone, it also becomes necessary to cut imports by reducing domestic absorption and growth. Thus the engineered reversal of a surge in capital inflows can result in considerable damage to the real economy and the financial standing of the country concerned.

85. Growing recognition of the dangers inherent in this type of volatility has produced policy responses. At the international level, there has been recent agreement by the IMF Interim Committee regarding procedures on the regular and timely provision of comprehensive and good quality data to the Fund by members for surveillance purposes, and regarding the establishment of exceptional procedures (the emergency financing mechanism) that would enable the Fund to respond promptly and prudently in the event of a financial crisis (see section D below).

86. At the national level, some countries have had recourse to specific measures designed to influence capital flows directly so as to reduce inward surges, or mitigate their effect. For example, minimum conditions have been laid down for external bond and equity issues; limits have been placed on banks' liabilities in foreign currencies or on their short-term obligations to non-residents; and queuing systems have been implemented to slow external borrowing by private firms. Actions to reduce the profitability of foreign borrowing have comprised the imposition of special reserve requirements on capital inflows; reductions in the availability, and increases in the cost, of swap facilities at the central bank; restriction of the assets which banks can acquire with liabilities denominated in foreign currencies to those with a low return; and the levying of a stamp tax on foreign credits. Financial outflows have been encouraged through the relaxation of restrictions on foreign in-

vestment by individuals and institutions such as pension funds, and on capital repatriation by foreign firms. Moreover, risks to foreign lenders and portfolio investors have been increased by a widening of the bands within which exchange rates are permitted to fluctuate.

87. Direct measures may also be used to stem or slow capital outflows. Their effectiveness for this purpose is likely to depend on their timing as well as their design. If their imposition coincides with a deterioration in perceptions of the creditworthiness of the country in question (for example, owing to a political crisis), it may be counterproductive and the capital outflow may actually accelerate (except in the unlikely event that the controls are so comprehensive as to stop all outflows). However, appropriately designed measures can increase the costs (and thus reduce the profitability) of most ways of taking speculative positions against a currency. Even if they are imposed after the outbreak of a foreign exchange crisis, they are capable of helping to slow the capital outflow.

88. Such measures include limits on foreign investment by residents and on their lending to non-residents, restrictions on residents' accounts in foreign currencies, raising the costs of (or otherwise restricting) forward-exchange and swap facilities at the central bank, the imposition of compulsory deposits at the central bank against rises in foreign-exchange exposure, and other measures limiting such exposure.

89. Direct measures to influence capital flows can augment the capacity of policy-makers to deal with capital account volatility. This is not to say that such direct measures should be used whenever developing-country capital markets are subject to external capital flows: individual country situations vary greatly, and some (perhaps many) countries will not judge such measures to be desirable. But direct measures should be part of the accepted policy arsenal available when and where needed.

90. For countries choosing to use them, direct measures need to complement sound underlying fiscal and monetary policies (and not be a substitute for them) and must be carefully tailored to minimize costs in terms of possible distortions and inefficiencies in capital and foreign-exchange markets. Further, since such costs, even when minimized, may be important, there needs to be a clear judgement that they are nonetheless smaller than the likely costs of coping with capital surges without direct measures.

### (c) *The phenomenon of marginalization*

91. Some developing countries, especially the least developed countries and other structurally weaker economies such as those in Africa, have been unable to benefit from, and meaningfully participate in, the globalization

process. This phenomenon of marginalization arises, *inter alia*, from the factors set out below.

(i) *Supply-side impediments*

92. The least developed economies are characterized by a variety of supply-side constraints or structural weaknesses which are a barrier to the expansion of both traditional primary products and non-traditional products, and to efficient import-substitute production. Difficulties directly related to commodity dependence are discussed in the next section. Additional supply-side constraints include: weak technological capacity; lack of entrepreneurial, marketing, and technical skills including those for quality control; paucity of long-term finance, expensive trade credit and pre-shipment finance; and non-transparent legal and regulatory frameworks. The preliminary results of a recent UNCTAD study on the financial systems of four African LDCs—Malawi, Zambia, Uganda and the United Republic of Tanzania—suggest that there is very little finance available for small farmers, small-scale enterprises, and long-term investors. The deficiencies in the physical infrastructure are also major constraints in many countries, especially because of limits on public expenditure programmes.

93. Globalization and liberalization have exposed additional supply-side constraints, and have given new dimensions to "traditional" constraints in the LDCs and other structurally weak economies as they attempt to adjust to the new, more competitive international environment—the main features of which are the utilization of new technology and production processes to increase efficiency.

(ii) *Commodity dependence*

94. Many developing countries, especially the LDCs and the other structurally weak economies, are heavily dependent on a base of non- or semi-processed commodities, both in production and for exports. This commodity dependence represents a major constraint on the ability of many developing countries to take advantage of the trading opportunities resulting from liberalization and globalization. Primary commodity prices are not only more unstable than those of manufactures, but they have also tended to move downwards in real terms over the past several decades. Such unfavourable characteristics have external and domestic implications, which have often combined to generate significantly adverse effects on the growth and transformation, macro-economic stability and sustainability, and creditworthiness of primary exporting developing countries.

95. In addition to these macro-level factors, the need to sell competitively in a falling market affects commodity producers at the micro level. Primary

production in poor countries is characteristically price-inelastic. Many infrastructural problems, such as the lack of irrigation facilities, inadequate research and extension services, and poor transport facilities make it very difficult for farmers to switch from one product to another in a timely fashion—or even at all—in response to new market opportunities. The sunk costs of investments for tree and other perennial plantation crops are another factor which weaken the supply response to price changes. A further factor compounding commodity sector vulnerability is that the share of land and other fixed assets in commodity production is very high. The pressing need to maintain employment, whether of family or hired labour, transforms wages partially or even wholly into another component of fixed costs. In these circumstances, production has to be carried on even in periods of falling prices.

96. An additional source of structural vulnerability in the sector is that agricultural production in a wide range of countries is often carried out by a very large number of farmers producing almost homogeneous products, certain quality differences notwithstanding. Thus, the impact of falling prices or demand, and of periodic price instability, tends to be more generalized and widespread than in the case of differentiated manufactured products coming from a smaller number of suppliers.

97. Moreover, technical progress and new discoveries in developed countries have significantly delinked the previously strong raw-material input/final output connection. Coupled with economic growth patterns and transformation which have become less material-intensive, there appears to have been some substitution and displacement of primary commodities, as well as some transmaterialization and dematerialization in certain industrial-country markets.

98. Nevertheless, some such countries have indeed been successful in using the commodity sector as a springboard for economic transformation and industrialization, thereby escaping the poverty trap which for so many other countries seems to be an inevitable result of their commodity dependence. There are several important lessons to be learned from the experience of success stories. The first is that both sound domestic macro-economic policies and political stability are *sine qua non* conditions for attracting investment, from both domestic and foreign sources, into activities aimed at diversification away from dependence on traditional export commodities. The second lesson is the importance of trade policy: many of the less successful countries have followed policies which effectively contained an anti-export bias for non-traditional products. At the same time, the experience of the "East Asian miracle" countries shows clearly that a "minimalist State" approach is inadequate (even if motivated by past inadequacies of intervention): most analysts agree that an important factor in the success of these

countries was the use of "enabling" State intervention to assist the private sector.

(iii) *Difficulties in attracting FDI*

99. Apart from the limitations in many cases arising from the political instability and lack of coherent and predictable policy environment, LDCs and other weak economies face a range of structural impediments to attracting FDI. These include :

(*a*) Low level of income and slow growth, as well as too small populations in many countries to offer attractive markets;

(*b*) The low level of domestic savings, coupled with a paucity of entrepreneurs, which reduces the scope for joint ventures and most non-equity forms of arrangements with foreign investors;

(*c*) The shortage in many countries of managerial and a wide range of technical skills, leading to inefficiencies and low levels of productivity;

(*d*) A lack of good infrastructure, notably a reliable power supply, good telecommunications, adequate transport facilities, and efficient water supply—all factors vital for modern industrial enterprises.

(iv) *The decline in official development assistance (ODA)*

100. Owing to their inability to attract FDI and other private capital inflows, LDCs and other structurally weak economies continue to depend heavily on ODA for supplementing their own domestic resources to finance development. After 1991, however, world ODA flows declined significantly in real terms. The ratio of ODA to GNP for DAC donor countries combined has fallen to 0.30 per cent, the lowest in more than two decades. DAC aid to the LDCs has dropped to 0.07 per cent of donors' GNP, lower than the ratio reached a decade ago, and less than half of the 0.15 per cent target. Moreover, Eastern Europe and the former USSR have ceased to provide ODA; and OPEC donors have curtailed aid substantially because of the deterioration of their own capital accounts.

101. Prospects for a significant increase in ODA in the near future are not particularly bright. There appears to be a high degree of aid fatigue and loss of public support in donor countries. Furthermore, aid fatigue is combined with a shift against public spending (and, separately, against international public spending) in many donor countries for reasons of domestic politics. One result is that the expected "peace dividend" which, it was thought, could help to boost ODA flows after the end of the Cold War, has never

materialized: much of the significant defence spending cuts has been used only to lower overall public spending. Another result is that public-sector programmes are being questioned more than ever before: for ODA, this means that donors are being required by their ultimate funders to show stronger proof of aid effectiveness and to counter impressions, right or wrong, that ODA was sometimes misused.

102. Aid is not necessarily given, in the aggregate, only on the basis of overall poverty or development needs. Bilateral ODA, which is nearly 70 per cent of total ODA, is often geographically allocated according to criteria which also include concerns—*inter alia* political ones—other than poverty alleviation or genuine development needs. This reflects difficulties for donors to adopt an aid distribution programme based on the development and poverty-alleviation needs of recipient countries, given the competing interests of their domestic funding sources and policy makers.

103. While aid supply is declining, demand for aid remains significant and other needs have emerged, adding to the traditional development needs. New claimants are also added to the list of recipient countries. Many of the new demands arise from the need to address global problems such as the environment, illicit drug trafficking, uncontrolled migration and massive refugee flows, relief associated with civil conflict, and eventually peace-keeping operations. Some of these claimants are programmes that are in the direct national interest of donors.

104. Given the stringent and growing supply constraints, it is more important than ever to establish clear priorities in aid allocation and to use resources more effectively. There is a strong case for refocusing ODA on poverty alleviation and development priorities, and for reducing its politicization. Clearly, more resources should be directed to the poorest countries. In this regard, donors should redouble their efforts to reach the aid targets for the LDCs. Country programmes could also be more focused on poverty. It is therefore imperative to implement rapidly the 20/20 compact approved at the 1995 World Social Summit in Copenhagen, which calls for a mutual commitment between interested developed and developing-country partners to allocate, on average, 20 per cent of ODA and 20 per cent of the national budget to basic social programmes.

(v) *Continued difficulties with external debt*

105. Despite claims to the contrary, the debt crisis persists in many developing countries. The crisis has changed in character since the early 1980s: it does not pose a systemic threat to the international financial system; it affects a different category of countries (mostly low-income countries); and the key problem now is official debt, both bilateral and multilateral. The principal manifestation of the crisis is the accumulation of massive arrears

and the frequent reschedulings. However, some countries continue to honour obligations, but at heavy social and economic costs. The various debt initiatives have not yet cleared the debt overhang which continues to bear on many countries and is a hindrance to investment and growth.

106. The adoption by the Paris Club in December 1994 of the Naples terms was an important step in the evolution of the debt strategy. These terms will significantly alleviate the debt burden of low-income countries if Paris Club creditors apply the country eligibility criteria flexibly so as to let all low-income countries with debt-servicing difficulties benefit from the 67 per cent reduction option. It is also important to allow a generous proportion of that debt to be considered for debt reduction: in the case of stock treatment, the size of the debt to be reduced is a critical factor in determining whether the debtor country succeeds in exiting from the rescheduling process.

107. Even with the full implementation of the Naples terms, many heavily indebted low-income countries would still face unsustainable debt burdens, largely because of the heavy weight of debt owed to multilateral financial institutions, which has increased rapidly in the past decade. These institutions, notably the World Bank and IMF, have adopted schemes to lighten the burden of debt by, in effect, refinancing hard loans with concessional funds. The "rights accumulation" approach has also been applied to deal with protracted arrears. However, considering the severity of the problem, the scope of these measures has been limited and resources inadequate. Bolder action is urgently needed to bring about a significant alleviation of the multilateral debt burden. In some cases this requires debt reductions.

108. Insufficient funding remains the principal constraint. A number of constructive proposals have been made recently which are designed to provide additional resources for multilateral debt relief without diverting funds from development assistance or increasing the pressure on bilateral donors. These proposals include: the sale of a portion of IMF gold reserves; a new SDR allocation, a portion of which would be used to provide multilateral debt relief; and drawing on the reserves and loan loss provisions of multilateral financial institutions. Serious consideration of these proposals is timely, as any multilateral debt facility designed to alleviate the multilateral debt burden of developing countries will be fully effective only if the associated funding is additional to ongoing assistance efforts.

### D. Managing a liberalized and globalizing world economy in the pursuit of growth and development

109. The rapid changes occurring in the world economy have numerous important implications for the formulation and execution of national poli-

cies. As mentioned above (see section 3 (*a*)) globalization and liberalization have tended to reduce policy autonomy at the national level. However, many of the policy concerns that can no longer be effectively addressed at the national level could, in principle, be addressed through coordinated action at the global level. Overall, the shift in the organization of private-sector activity from the national to the global level has not been matched by a shift in the organization of public policy from the national to the global level. This is true for the regulatory environment governing the activities of private firms (see chapter III, section C.2) as well as for macro-management. The establishment and further evolution of international frameworks governing trade, international investment and money and finance are critical elements in the development of systems of global governance.

### 1. Globalization, interdependence and economic management

110. The process of globalization, as manifested in the internationalization of production and markets, has given substantial impetus to the growth of interdependence of national economies, as well as of interlinkages in economic activities in areas such as trade, investment, money and finance. In view of the economic interdependence among countries, the ability of national policy makers to achieve national goals by using the policy instruments at their disposal has declined, while policies and developments outside a country's borders have come to have considerable influence on the country's economic development. For example, national monetary policies have immediate international consequences. This is particularly true of the larger industrial economies, but even the policies and developments in smaller economies may produce international consequences similar to those of the larger countries. Just as the United States' decision in early 1994 to raise interest rates produced a worldwide collapse in bond prices, causing losses which exceeded the United States stock market crash in 1987, so too the devaluation of the Mexican peso later in the same year led to a significant fall in emerging equity markets throughout Latin America and Asia.

111. The effective management of interdependence is thus acquiring increasing importance in the context of achieving sustained growth and development in a liberalized and globalizing world economy. This requires, among other things, stronger international cooperation to ensure compatibility of policy objectives at three levels: among national objectives of growth and full employment in the major industrialized countries; between those, and the objectives of growth and development in developing countries; and between all of the above objectives and global environmental and social objectives. The management of interdependence must also address the problems of achieving greater coherence and consistency among policies in the interrelated fields of trade, investment, money and finance. The close con-

nections, and thus the potential for mutually disruptive effects, of policies in these fields has long been recognized: for example, currency devaluation has competitive effects similar to those of an increase in import tariffs combined with export subsidies; trade policies can both stimulate and impede foreign investment; and countries which borrow from international financial markets may experience deteriorations in the services account of the balance of payments due to a rise in international interest rates which more than offset improvements in the goods balance. The difficulties which result from such relations are generally important for developing countries whose economies are more vulnerable to abrupt external shocks in the international markets for finance and goods.

112. The need for coherence in global policy-making was explicitly recognized in the Marrakesh Ministerial Declaration which accompanied the Agreement on WTO. The Declaration emphasized the role of greater exchange rate stability—based on more orderly underlying economic and financial conditions—in the expansion of trade, sustainable growth and development, but also explicitly recognized that difficulties whose origins arise outside the trade field cannot be redressed through measures taken in the field of trade alone. While the Declaration notes that the strengthened multilateral trading system has the capacity to contribute to more effective surveillance of policies, it leaves open the modalities of such surveillance.

113. Within the framework of WTO, governments have accepted a major loss of policy autonomy by agreeing to restrict the use of trade-policy instruments in the context of multilaterally agreed commitments. This was deemed necessary for the evolution of an international trading system that can meet the challenges posed by a liberalized and globalizing world economy. A similar reasoning would suggest that the principles and standards of GATT and WTO might also serve as the starting-point for reflection on the construction of a framework for effective surveillance and the resolution of conflict over monetary and financial issues. These principles are non-discrimination and the avoidance of measures conferring unfair competitive advantage, as well as the recognition of the need for safeguards and preferential treatment for developing countries. Thus market access would be an overriding goal, but policies might be singled out for international examination, and might be considered actionable, if they cause harm to another country's capital market or balance-of-payments position. Any policy which could be shown to benefit one country only at the expense of another, rather than improving the conditions in the global economy, could be brought for resolution. The issue of sanctions could also be considered.

114. In the past, there have been diverse efforts at improving the international coordination of macro-economic policies in IMF, the G-10, the G-7 and the G-5. This experience clearly demonstrates the extraordinary com-

plexity and difficulty of any such undertaking. Attaining a symmetrical and effective surveillance of national policies would certainly require some ceding of national sovereignty, as well as the participation of all countries. However, these difficulties are common to all aspects of global governance and were successfully dealt with in the case of trade. This example, and the approaches that made for success, can provide guidance as other aspects of global governance are tackled.

## 2. Evolving institutional, legal and regulatory frameworks

### (a) *The international trading system: new and emerging issues*

115. The reduction and elimination of tariffs and other frontier trade barriers, and the intensification and extension of multilateral trade disciplines achieved in the Uruguay Round and consolidated with the establishment of WTO, have provoked initiatives to continue the process of extending multilateral trade disciplines to related areas of economic policy. These are reflected in the "new issues" identified in the Concluding Remarks of the Chairman of the Marrakesh Ministerial Meeting and in subsequent initiatives in other forums. The preoccupations of the proponents and the objectives sought differ, and reflect different and even conflicting responses to the forces of globalization and liberalization.

116. OECD has articulated a broad concept of market access, which encompasses not only the conditions for export into the market but also the conditions for investing and conducting business in it. This approach is based on the notion that markets are not really open until foreign firms enjoy opportunities for producing and marketing goods and services in it which are equivalent to those of domestic firms, including protection against anti-competitive practices of the private sector which might frustrate the multilateral market-access disciplines. Hence the proposals to establish new multilateral rules in the areas of investment and competition policy involving the acceptance of the principle of national treatment for, and most-favoured-nation treatment among, foreign investors; and the introduction of multilateral rules for competition policy under which governments would be obliged to take action to eliminate anti-competitive practices. The thrust of this package would be to maintain the momentum towards even further liberalization by reinforcing the globalization process.

117. A related line of thinking focuses on differences in national policies, or in the application of international norms, which could create unfair competitive opportunities and thereby frustrate multilateral disciplines aimed at free competition and distort the flow of trade and investment. The concern here is to avoid a firm-driven "race to the bottom" in which countries com-

pete to establish the most favourable conditions for investment and the most competitive conditions for export production by providing fiscal incentives to firms, thereby burdening government budgets, lowering social welfare responsibilities of firms and labour as well as environmental standards, and loosening competition policy rules. Pressures for such "policy harmonization" also arise from concerns that globalization and liberalization can lead to the erosion of social welfare programmes, resulting from the increased ability of private enterprises to seek to locate in those jurisdictions where they find the regulatory and fiscal structure less constraining.

118. These factors combine to create political pressures for a harmonization of policy measures among countries in pursuit of what has been termed the "level playing-field". Domestic political pressures for such harmonization become even more acute when moral or ethical considerations are introduced into the discussion. The proposals for including the links between international trade and labour rights, environmental protection and competition policy can be seen in this light.

119. The proposal by some major trading countries at Marrakesh to include the issue of trade and labour standards in the future agenda of WTO is based on the claim that, through the non-enforcement of ILO Conventions, countries can artificially reduce costs to obtain unfair trade advantages. It would thus negate the efforts undertaken in the Uruguay Round to liberalize and strengthen the multilateral trading system. However, many countries have strongly opposed any link between labour issues and trade obligations as they consider that this would open up new possibilities for protective measures and harassment of trade. Furthermore, some developing countries proposed at Marrakesh to link immigration policies and international trade. This proposal was partly motivated by the limited character of commitments with respect to the temporary movement of natural persons in the General Agreement on Trade in Services (GATS), and partly by the concern that their participation in the international division of labour and their development process were affected by the fact that the international mobility of labour was becoming more restricted as a result of tighter immigration policies, while the mobility of capital and investment was being increasingly facilitated.

120. Concern has also been expressed that multilateral trade disciplines can also be frustrated by action and policy measures which are not covered by comparable levels of discipline. Most evident are the distortions caused by imbalances in the stringency in multilateral disciplines governing different areas of economic policy. The much tighter constraints on national trade policies resulting from the disciplines negotiated in the Uruguay Round Agreements contrast sharply with the virtual absence of discipline over national monetary policies (see preceding section).

(b) *Current trends in the evolution of arrangements governing foreign direct investment*

121. The dramatic increase of FDI and the growing role that TNCs play in the world economy has focused attention on the role that a stable, predictable and transparent international framework could play in facilitating, promoting and guiding essential TNC functions, particularly in mobilizing the capital, skills and technological resources required to meet world growth and development needs. To be effective, the liberalization of FDI regimes must be accompanied by intergovernmental cooperation to ensure the efficient functioning of the market. In particular, there is a need to coordinate efforts aimed at avoiding restrictive business practices among firms and elaborating standards for consumer, health, safety and environmental protection. In this context, there is also a need for multilateral cooperation to rationalize the use of incentives aimed at channelling FDI away from other countries in order to avoid market distortions and ensure that investment decisions enhance not only national welfare but also global welfare.

122. At present, there is no overall multilateral framework for FDI. Instead, the present international arrangements consist of a variety of instruments which differ considerably from one another and which, in line with changes in the world economy, are themselves changing along three main trends:

(i) The intensification of policies aimed at facilitating and attracting FDI. This represents the most obvious and widespread change in the regulatory climate since the early 1990s, encompassing most countries in all regions.

(ii) The continuing proliferation of bilateral treaties for the promotion and protection of FDI (BITs). These instruments are expanding in number and scope so as to complement national protection standards, and to facilitate and promote FDI flows. Some recent BITs have introduced new commitments regarding entry and establishment as well as the prohibition of performance requirements.

(iii) The expansion of regional and multilateral agreements on FDI. A number of recently concluded regional agreements such as NAFTA and APEC have adopted provisions addressing FDI standards and regulations.

123. In recent years, a number of initiatives aimed at evolving a multilateral framework for FDI have been taken. In 1992, the Development Committee of the World Bank called the attention of governments to a recommended set of "Guidelines for the Treatment of Foreign Direct

Investment''. At the same time the World Bank's Multilateral Investment Guarantee Agency (MIGA) and the International Centre for the Settlement of Investment Disputes (ICSID) have provided mechanisms for insurance and the settlement of disputes, which are usually considered to be necessary ingredients of a facilitating framework.

124. The Uruguay Round of multilateral trade negotiations addressed a number of investment issues for the first time. The Agreement on Trade-related Intellectual Property Rights (TRIPs) should provide a major stimulus to FDI. The GATS provides a framework for the negotiation of sectoral-specific commitments with respect to foreign investment in services; the Agreement on Trade-related Investment Measures (TRIMs) prohibits investment measures which infringe upon trade obligations, and envisages future consideration of broader issues of investment policy. The OECD National Treatment Instrument and its liberalization codes for capital flows and invisible transactions provide non-binding rules on investment; negotiation of a binding ''Multilateral Agreement on Investment'' has recently been launched in OECD.

125. These arrangements provide the elements of a framework for further international cooperation on FDI aimed at facilitating global investment decisions and using the opportunities for growth and development that accompany them, in the broader context of enterprise development, especially in developing countries. Such cooperation could aim at giving clarity and coherence to the positive standards that have been established at various levels for FDI in areas such as entry and establishment, national treatment, settlement of disputes, fair and equitable treatment and transfer of funds.

### (c) *Current trends in the evolution of the regulatory framework for international financial flows*

126. Against the background of increasing risk of financial instability arising from financial liberalization and integration, there is wide recognition of the need for international action to improve and coordinate national regulatory frameworks for international financial transactions. An agreement was reached in 1988 by members of the Basle Committee on Banking Supervision to establish capital standards for credit risk. More recent work in this Committee has included an initiative to establish such standards for market risk.

127. However, the proposals of the Bank for International Settlements are aimed primarily at the internal operations of the global financial institutions themselves in the interest of their own stability. They do not aim at preventing global financial instability resulting from their operations. This will re-

quire international regulation and surveillance of the operations of the banks and other financial institutions operating in international financial markets, as well as increased dissemination of information on the activities of these institutions.

128. With the growing integration of international financial markets and the increased contagion risk, the issue of who will play the role of international lender of last resort has acquired greater importance. This problem became obvious in the recent experience of Mexico, where a liquidity crisis led to the collapse of the currency before an international lender-of-last-resort agreement could be put together. The subsequent multilateral support operation, which was mounted on an ad hoc basis, raised several practical and procedural questions.

129. The main traditional multilateral instrument for providing financial support to countries in balance-of-payments difficulties is financing under arrangements with IMF. However, subject to certain minor exceptions, under IMF Article VI the Fund's resources have not in the past been available to finance large or sustained outflows of capital. Other major sources of external payments support are of a more restricted nature and in many cases are linked to regional economic agreements. Such sources include reciprocal currency or swap arrangements between central banks, principally those of OECD countries, and various EU facilities.

130. In October 1995 the Interim Committee endorsed the decision of IMF's Executive Board to establish exceptional procedures that would enable the Fund to respond to serious financial crises. The precise nature of these procedures is not yet clear, but the resources may eventually include those which would become available under the initiative of the Group of Ten to develop new parallel financing arrangements complementing the General Agreements to Borrow. These procedures represent a step in the direction of more comprehensive global lender-of-last-resort facilities, and future experience with them will show how adequate a response they represent to the problem of large capital flows.

### E. Conclusions

131. The processes of globalization and liberalization provide a new and constantly evolving framework within which sustainable development must go forward in the period ahead. These processes, especially the phenomenon of globalization, are taking the world economy into largely uncharted waters, and are giving rise in many countries to new uncertainties and anxieties regarding growth and prosperity and the distribution of their benefits. This is

particularly the case for developing countries, where there are grounds for anxiety if a country is being drawn rapidly into the globalizing world economy, and equal—or greater—grounds for anxiety if it is not. This suggests the need for continuous and detailed monitoring by governments of the effects and impact of liberalization and globalization on development. In this connection, particular attention would need to be given to the evolution of the systems governing international transactions, to ensure that this evolution is "development-friendly".

132. In the period ahead there is a wide range of opportunities in the areas of trade, investment and finance which have recently emerged and which, if properly grasped, can be utilized to accelerate development. There are also, of course, significant challenges. Opportunities and challenges in the area of trade, and their specific implications for policies, are taken up in chapter II of this report. These implications, as well as specific policies in the areas of investment and finance, need to be approached by individual developing countries, as always, within the framework of a broad strategy for promoting development. For if globalization and liberalization establish certain parameters for policy success that cannot be ignored, they do not mark the end of development economics or of the need for development strategies.

133. Moreover, there is not yet a full and complete understanding of several important aspects of successful development policies. The policy lessons to be learned from the development experiences of the East Asian economies remain to be fully explored and incorporated into the panoply of measures generally available to policy makers. The question of the appropriate pace and extent of the integration of the financial system of an individual developing country into the global financial system is also outstanding, as are issues relating to how best to maximize the development impact of the activities of transnational corporations. An examination of the ingredients of successful development strategies must thus be pursued, so that each individual country can have at its disposal a full understanding of the options on the basis of which its own strategy can be constructed or revised.

134. The threat of marginalization and the challenges that it presents must redirect the attention of policy makers to the implications of commodity dependence for development prospects and for successful development strategies. This issue, as well as broader trade issues facing weaker, commodity-dependent economies, is taken up in chapter II.

135. A main objective of any viable development strategy must be the fostering of a vibrant, dynamic and competitive private sector. Policies for enterprise development, and for establishing and sustaining an appropriate dialogue between government and the private sector must thus stand at the centre of any successful development strategy. For in the final analysis it is

the enterprise itself that is the motor of growth and change—the creator of employment, the creator and/or adaptor of technology and the accumulator of wealth—and its development thus becomes synonymous with development in general. Issues related to enterprise development and associated policies are taken up in chapter III.

*Chapter II*

# PROMOTING INTERNATIONAL TRADE AS AN INSTRUMENT FOR DEVELOPMENT IN THE POST-URUGUAY ROUND WORLD

136. As argued in the preceding chapter, globalization and liberalization have created the premises for international trade to become an engine of economic growth on an unprecedented scale. The scope for deepening and widening the international division of labour has been greatly increased by the successful conclusion of the Uruguay Round, as well as by the adoption by the developing countries of outward-oriented growth strategies. It is expected that the present trend whereby the pace of world trade growth outstrips that of world output will strengthen in the period to come, and with it the increased participation of all countries in international trading.

137. How to facilitate the economic and institutional integration of developing countries and countries in transition into the world trading system is a major challenge for international economic cooperation. It is also an issue of special interest to the developed countries. The gains to industrial countries from increased trade integration with developing countries are potentially larger than the gains from additional integration among themselves. Trade integration arising from the ongoing liberalization process and from its extension to new areas such as services is likely to generate dynamic gains from increased market size, competition and technology transfer. As developing countries are forecast to grow about twice as fast as industrial countries, and as countries in transition develop stronger supply capacities and become more competitive internationally, the dynamic gains from increasing trade with them are likely to be specially important.

138. The realization of these gains will, however, depend on the extent to which the adjustments required by the process of integration are carried out. International trade can only fulfil its potential as an engine of global economic growth if the necessary reallocation of resources in line with countries' different and changing comparative advantage is allowed to take place and the inevitable frictions and protectionist pressures that will arise in implementing appropriate structural adjustment policies are resisted. Furthermore, the weaker trading partners, especially the LDCs and commodity-dependent economies, must be enabled to strengthen their economic, techni-

cal and human capacities to engage in trade and to participate fully in the multilateral trading system.

139. Not all developing countries are equally able to seize the new opportunities in international trade that are likely to arise in the process of globalization. For example, the speed of integration in international trade of LDCs since 1990, measured by the differential between the growth rate of trade and output, has only been one-third as fast as that of developing countries as a group. A similar situation is faced by many commodity-dependent economies which have not been successful in utilizing their commodity sectors as a springboard for economic growth and structural transformation or in reducing their dependence on one or two commodity exports. These countries and other structurally weaker economies are also poorly equipped to participate in the multilateral system of trade rules and disciplines. The danger of marginalization of a large number of countries in the international trading system is therefore real.

## A. Opportunities and challenges for promoting economic growth and sustainable development

140. The trade liberalization resulting from the Uruguay Round and from regional economic integration, combined with the autonomous liberalization measures of developing countries, has created both opportunities and challenges for promoting economic growth and sustainable development. The economic impact of these liberalization efforts will, however, be spread out over a number of years because the Uruguay Round Agreements provide for a phased implementation of commitments and because economies will take time to adjust to policy changes.

141. Meanwhile, there are likely to be transitional impacts. First, varying time-lags in the expansion and contraction of industries due to the policy changes induced by the Agreements imply that the factors released from contracting industries may remain unemployed for a period before they become reabsorbed in expanding industries. Second, while the reductions in MFN tariffs will increase market opportunities in general, they will also put a competitive squeeze on the exports of those countries whose access was hitherto facilitated by preferential tariffs. These countries are likely to experience a transitional loss of export revenue. Other short-term effects are expected as a result of the reform process in agriculture and of the reforms concerning intellectual property rights. The reform process in agriculture could lead to higher prices for basic food products and therefore involve transitional costs in terms of higher import bills for low-income food-deficit developing countries. On the other hand, the extended and stricter patent

protection is likely to result in higher prices for high-technology and pharmaceutical products.

142. The likelihood of adjustment pressures on developing countries was recognized at the Marrakesh Ministerial Meeting in 1994. As a result, the Uruguay Round Agreements incorporate a range of measures aimed at spreading out the adjustment process in order to minimize costs. These measures should, however, be complemented by a positive approach designed to smooth the process of economic adjustment by addressing the rigidities which slow it down. International support should be mobilized for the efforts by developing countries to rationalize resource allocation and develop supply capabilities, as well as to increase the elasticity of supply in critical areas by encouraging investments in food production and non-traditional export industries and in labour retraining schemes.

143. As indicated in chapter I, special attention should be paid to the contribution of the services sector to development and the role of trade in services, as well as access to efficient ways of trading (especially through electronic commerce) in the integration of developing countries and economies in transition into the world economy. Given the rising service intensity of production, a strong producer services sector has a major impact on the competitiveness of firms and of the economy as a whole, and consequently on the chances of success of export-oriented development strategies. Moreover, global competition is now characterized by a declining trend in the share of profits arising from product- or process-based comparative advantage, with a correlative increase in profitability and competitiveness based on information advantages and reductions in transaction costs. Strengthening service capacities in general, and capacities for "trade efficiency" in particular, is thus a major challenge for developing countries in the period ahead.

144. Particular difficulties are faced by the primary commodity export-dependent developing countries in using international trade as an engine of economic growth and sustainable development. These are mostly low-income countries, with a large proportion located in sub-Saharan Africa. Because of their heavy commodity dependency, the economies of these countries tend to be highly vulnerable: generally, they are characterized by a high degree of export-earnings instability, a persistent decline in the terms of trade, a high external debt burden, small inflows of foreign direct investment, and limited developmental linkages within the domestic economy.

145. In sum, the immediate task for national and international policy is to secure an enhanced role in world trade for developing countries and countries in transition through export expansion and diversification, in terms of both products and markets. This objective can be promoted through policies and actions designed to strengthen supply capabilities and capacities for

trade efficiency, to improve market access, and to help the weaker countries overcome transitional difficulties and constraints arising from commodity dependence. Institutional integration can be promoted by helping countries to participate actively in the multilateral decision-making process, to meet their new obligations deriving from the Uruguay Round Agreements and to defend their rights effectively. As for non-members of WTO, it also involves facilitating accession to the Organization. Integration can also be promoted through strengthening the capacity of developing countries to formulate and pursue autonomous trade liberalization policies, as well as by strengthening regional integration to enable them to diversify markets and take full advantage of global trading opportunities.

## B. Enhancing the participation of the developing countries and countries in transition in international trade: policy approaches and measures

146. Achieving enhanced participation of developing countries and countries in transition in international trade calls for measures and actions aimed at improving national and international trade policy, developing trade efficiency and addressing commodity dependency.

### 1. Trade policy

#### (a) *Effective implementation of the Uruguay Round commitments and further liberalization*

147. The first urgent objective is to ensure effective implementation of the Uruguay Round results, especially in the area of market access for goods and services of export interest to developing countries and countries in transition. As already indicated, the Uruguay Round Agreements leave considerable margin for interpretation; this allows countries an element of discretion in their trade policies that may lead to the reintroduction of protectionist measures. It is essential that countries, and particularly major trading nations, implement their commitments fully and exercise appropriate restraint in the application of trade remedies such as safeguards and anti-dumping and countervailing measures against products of developing countries and countries in transition.

148. Furthermore, the Uruguay Round Agreements contain a built-in future work programme containing commitments to launch new negotiations aimed at further trade liberalization in agriculture and services beginning around 1999; the negotiation of certain missing provisions in the GATS; a

review of the possibility of extending the Agreement on Trade-Related Investment Measures (TRIMs) to cover investment and competition policy; and a series of reviews of the operation of various Agreements which could lead to proposals for their amendment. To continue the momentum toward further liberalization of multilateral trade and the increased participation of the developing countries, there would also be a need for further multilateral trade negotiations on trade liberalization to focus on issues related to tariff peaks and tariff escalation.

149. In the agricultural sector, where various analyses have shown that the process of tariffication has led in several cases to the establishment of tariffs that provide more protection than the non-tariff barriers they replaced, the objective would be to reduce out-of-quota tariff rates to non-prohibitive levels. The approach to tariff reduction should also include the goal of reducing tariff escalation on products of interest to developing exporting countries to give them increased access to markets for processed products and to promote the diversification of their traditional commodity exports into higher-value-added products. Experience with the implementation of the Agreement on Agriculture—for example, in the administration of tariff quotas, the actual incidence of reduction commitments on those products most subject to export subsidies and domestic farm support—should reveal specific priorities for further liberalization in this sector.

150. In the services sector, within the context of the GATS, negotiations are continuing on maritime transport and basic telecommunications services; on achieving a truly MFN-based agreement on financial services; on formulating a set of rules on subsidies, safeguards and government procurement; and on disciplines to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements in the field of professional services do not constitute unnecessary barriers to trade.

151. Progressive liberalization of services, in accordance with the objectives of the GATS, will be based on the promotion of interests of all participants on a mutually advantageous basis and on securing an overall balance of rights and obligations, including obligations on increasing participation of developing countries in trade in services. The latter relate to strengthening of the domestic services capacity of developing countries, *inter alia* through access to technology, the improvement of their access to distribution channels and information networks, and the liberalization of market access in sectors and modes of supply of export interest to them.

152. The inclusion of the "temporary movement of natural persons supplying services" within the definition of trade in services in the GATS responded to the concern of developing countries that this was the main mode of supply of labour-intensive services in which they were deemed to possess

a comparative advantage, and in order to maintain a symmetry between movement of factors of production as part of the compromise to include investment within the scope of the GATS. However, the post-Uruguay Round negotiations on movement of natural persons, which were supposed to achieve higher levels of commitments, have only resulted in some limited improvements on the part of a few developed countries.

153. Pending further liberalization in the next round of negotiations, steps could be taken in the meantime to ensure increased transparency regarding immigration legislation and regulations and non-discrimination in the movement of persons from different countries. Measures could also be taken to reduce the restrictive impact of economic needs tests and to exempt more categories from such requirements. Access opportunities could also be improved by allowing the temporary movement of service teams and project personnel.

154. Although unconditional MFN treatment is a basic obligation under the GATS, time-bound exemptions are allowed. The fact that some of the MFN exemptions are couched in terms that would cover future measures and that most of the measures scheduled will apply for an indefinite period brings in an element of sector-specific reciprocity and conditionality. The outcome of the negotiations on financial services clearly demonstrates how sectoral interests could endanger the integrity and comprehensiveness of the GATS and the basic principle on which the whole multilateral system is established, namely non-discrimination. Criteria therefore need to be developed to ensure that exemptions from MFN treatment would indeed be reviewed and phased out without additional payment, with a view to ensuring that the multilateral approach of the GATS is applied as far as possible to all sectors and modes of supply.

155. In order to enable developing countries to extract the expected economic benefits from the provisions of Article IV of the GATS, this Article would need to be supplemented by additional principles relating to capacity-building in services sectors, access to and use of distribution channels and information networks, and liberalization in sectors and modes of supply of export interest to them. Developing countries undertaking programmes to liberalize their services sectors should be provided with assistance to enable their firms to acquire the capacity necessary to compete in the domestic and export markets.

### (b) *Measures to alleviate transitional costs*

156. The burden of adapting to the results of the Uruguay Round will be borne to a relatively greater extent by developing countries, and particularly

by the least developed and net-food-importing developing countries. The acceptance by the international community of the need to assist these countries to face the challenges and difficulties posed by reform and the liberalized international trading context—and in particular to adjust to possible increases in prices of imported foodstuffs—constituted a significant step. It was embodied in the Marrakesh Ministerial Decisions on Measures in Favour of Least-Developed Countries and on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Countries. The challenge, which has been addressed in several high-level meetings, is to translate these commitments into concrete action and the Conference should contribute to this process. The primary focus of such action should be on minimizing the transitional costs to be borne by these countries.

157. However, the problems facing many developing countries in adapting to the post-Uruguay Round trading system extend beyond such emergency measures. Developing countries which are unable to compete effectively in international trade or to defend their interests within the multilateral framework of rights and obligations will become further marginalized. Thus, measures must be taken to assist developing countries to increase their competitiveness in world markets in the light of reduced preferential tariff margins, to effectively implement the multilateral trade agreements, notably in setting up the necessary institutions and domestic mechanisms, and to defend effectively their rights and interests in multilateral and regional forums. The Conference could define a specific action programme of technical and financial assistance in this respect.

158. More specifically, to offset the possible deterioration in LDC trade balances, a range of measures would be required. The Marrakesh Ministerial Decision on LDCs and net-food-importing countries points to the need for improved conditions for, and an increase in, food aid (paragraph 3(i) and (ii)) and for balance-of-payments support through access to compensatory financing schemes (paragraph 5); as stated in chapter I, more vigorous debt-relief measures are also necessary. Simultaneously, efforts by LDCs to improve agricultural production and infrastructure should be supported by the provision of technical and financial assistance (paragraph 3(iii)). Financial assistance is also required to help upgrade the transport and communications infrastructure in LDCs and ensure availability of essential medicines at affordable cost to their populations.

159. Trade measures should aim at improving the trading opportunities of the LDCs, taking into account the erosion of preferential margins, as well as their limited capacity to participate in an increasingly competitive global market in goods and services. Steps should, therefore, be taken to maximize the remaining possibilities for preferential treatment (improvements in GSP schemes for the LDCs are proposed below). Additional measures to help the

LDCs compete in world markets could involve the removal of all remaining barriers to imports from LDCs and effective action by the relevant agencies in the major markets to promote imports from these countries. More specifically, in applying anti-dumping and countervailing duties, the LDCs could be exempted from any cumulative assessment of injury, and importing countries could refrain from taking safeguard action against LDC imports. As for textiles and clothing, LDCs could be exempted from all restrictions during the ten-year phase-out period established by the Agreement. At the same time, LDCs' participation in trade in services could be enhanced by: effective application of Article IV of the GATS on a unilateral basis so as to liberalize sectors and modes of supply (i.e. movement of persons) of interest to them; facilitating their access to information networks and distribution channels and to technology; and giving LDC suppliers of services facilitated access to information.

160. LDCs also need support in the development and diversification of their production and export bases, including those of services, as well as in trade promotion, and the Decision on LDCs calls for substantially increased technical assistance for these purposes (paragraph 2 (v)). Finally, LDCs will also require technical cooperation to strengthen their institutional capacity to deal effectively with an increasingly complex international trading system. In addition to helping LDCs identify new trading opportunities in particular sectors and markets, assistance will need to focus on human resource development in the areas of export production, diversification and promotion as a means of strengthening export supply capabilities. Particular attention should be devoted to identifying appropriate technologies, including in the public domain, which could considerably reduce the high cost of imported technology resulting from the implementation of the TRIPs Agreement.

### (c) *Measures to enhance the effectiveness of the generalized system of preferences (GSP)*

161. The contribution of the GSP to export growth of developing countries has been significant but not evenly distributed. Those beneficiaries which have both the supply capacity to take advantage of the market opportunities and the administrative capacity to identify the opportunities and conform to the required documentary procedures have derived maximum benefits. This problem can be corrected not by the graduation of such countries, but through the expansion of product coverage and technical and financial assistance to the less competitive beneficiaries.

162. Important limitations in product coverage, among them the exclusion of key sectors of interest to developing countries (such as textiles and agriculture), have significantly reduced the positive impact of the GSP schemes in that only half the dutiable products for developing countries are covered

by the schemes. This, combined with stringent rules of origin, tariff quotas, difficulties in complying with the procedural requirements and lack of information, results in three quarters of all dutiable imports from developing countries not receiving GSP treatment. In addition, there is a tendency to introduce greater conditionality and complexity in the schemes through the inclusion of provisions on social and environmental standards.

163. The Uruguay Round MFN tariff reductions have resulted in an erosion of preferential margins, as has the extension of free trade areas and customs unions. This process can be expected to continue. Thus, in the longer run the GSP is likely to lose its importance as a means of providing competitive opportunities to less competitive countries. However, in the short and medium term, for the GSP to continue to play a significant role in enhancing the participation of developing countries in international trade, its effectiveness would need to be enhanced in two respects in particular. Firstly, preferences should be sufficiently secure so as to enable exporters in developing countries to build an export strategy on them. Secondly, the benefits of the GSP should accrue to the largest possible number of countries.

164. Specific measures to enhance the effectiveness of the GSP should include: extension of product coverage to agricultural and resource-based products, tropical industrial products, leather, footwear, metals and minerals, textile and clothing products; the establishment of multilaterally agreed criteria for country/product graduation from the GSP; and the harmonization of GSP rules of origin among preference-giving countries, drawing on the Uruguay Round Agreement on Rules of Origin. The extension of product coverage will not only reduce the existing mismatch between the export structure of GSP beneficiaries and the product coverage of the major GSP schemes, it will also enable more developing countries to benefit from the schemes.

165. In order for the LDCs to derive adequate benefits from the GSP, the special treatment accorded to them needs to be strengthened through: (i) the granting of comprehensive product coverage to all dutiable products, including agricultural and textile products; (ii) the relaxation of existing rules of origin to include full and global cumulation and flexible administration of documentary and shipment requirements (this point was particularly emphasized by LDCs at the twenty-second session of UNCTAD's Special Committee on Preferences in October 1995); and (iii) enhanced support for the technical cooperation programme on GSP.

### (d) *Assistance to enhance the capacity of the developing countries and countries in transition to participate effectively in the WTO system of rights and obligations*

166. An increased reliance on international trade in the development strategies of many developing countries was accompanied by their more ac-

tive participation in the Uruguay Round of multilateral trade negotiations and in the GATT/WTO system of multilateral trade rights and obligations. Thirty-two developing countries and territories acceded to GATT during the Uruguay Round or before WTO's entry into force as from 1 January 1995, thus bringing the total number of GATT contracting parties to 128 by the end of 1994. All of these countries qualified to become members of the WTO. In addition, about 15 developing countries have initiated their accession negotiations to WTO since then. Concerning the economies in transition, several of them had been GATT contracting parties before the Uruguay Round, one country (Slovenia) acceded to GATT after the conclusion of the Uruguay Round and thus was eligible to become an original WTO member, and many others are in the process of acceding to WTO. It is expected that WTO membership will continue to expand. The trend towards more universality of the WTO membership is thus evident. On the other hand, some of the most important trading nations, like China and the Russian Federation, are not members. It is widely recognized that the WTO system cannot be regarded as universal as long as this situation continues.

167. Accession to WTO poses important institutional challenges to the country trying to accede. The extension and intensification of obligations as compared to "GATT 1947" has greatly complicated the accession process. Countries are facing increasing demands which, in certain cases, go beyond the scope of the Agreements. This is particularly true of acceding countries in transition, which in some cases are still affected by trade restrictions introduced to deal with the previous economic regimes.

168. Countries in transition face a complex internal and external situation which may complicate their accession negotiations. They are undergoing a fundamental transformation into market-based economies, and integration into the international trading system plays a central role in the process. They will undoubtedly need a degree of flexibility with respect to putting in place trade regimes which are consistent with WTO membership. For example, these countries' tariff regimes have only begun to develop over the last two to three years and, in some cases, are still not in place; the approaches applied in the Uruguay Round to maximize tariff cuts and tariff bindings of all participants may not necessarily be applicable to countries in transition. Another matter of concern for them would be in the new areas falling within WTO competence—i.e. trade in services and protection of intellectual property rights—where, in general, many essential aspects of foreign trade regimes, legislation and regulations are still missing, while national policies in those areas are still being worked out.

169. Given the link between accession to WTO and the transition to a market-oriented economy, it would be desirable for the systemic transformation of these countries to be given priority in the accession negotiations.

Thus, issues concerning reduction of tariffs and other restrictions to trade should be dealt with in the context of resumption of economic growth, structural adjustment and the increased capacity of their economies to compete internationally. In addition, it should of course be ensured that WTO membership would result in elimination of the "residual" discriminatory elements still existing in the trade regimes of major trading countries *vis-à-vis* countries in transition.

170. A further challenge facing developing countries and countries in transition concerns their ability to exercise their rights and meet their obligations under the WTO system. Apart from substantive obligations and rights, WTO members must also satisfy onerous procedural requirements. There are, for example, some 160 notification requirements arising from the Agreements. In some cases, the implementation of notification obligations may affect the substantive rights of a WTO member, including the use of provisions on differential and more favourable treatment in the case of a developing-country member. Active participation in the WTO system will also require constant involvement in the work of WTO councils, committees and working parties, as well as in the ongoing negotiations on some specific issues. Finally, an active defence of rights will depend on a country's ability to use the WTO dispute settlement mechanism in the case of a trade conflict.

171. Many developing countries and economies in transition—both existing and aspiring members of WTO—will have to strengthen their capacity in the areas of trade policy formulation and negotiation and institutional adaptation, since the depth and range of expertise required are often not available to them. This weakness will also affect their ability to deal with the complex unfinished business of the Uruguay Round and with the new issues on the international trade agenda. It is therefore incumbent upon the international community to formulate a programme of assistance for these countries, which would otherwise not be able to participate effectively in the international trading system.

### (e) *Structural adjustment policies of developed countries*

172. As the world economy becomes more global and trade liberalization continues, industries in all countries will face growing pressures to adjust their patterns of production and trade to changing competitive positions. Responding to this challenge calls for improving productivity and product quality, refining product lines, retreating from areas in which industries are no longer competitive, relocating in lower-cost countries and shifting into new activities with longer-term growth potential. Governments can facilitate such structural adjustment by creating a favourable macro-economic policy environment, as well as by adopting cross-sectoral or industry-specific

measures which aim to influence the process of adjustment at the micro-economic level.

173. UNCTAD member States have agreed that structural adjustment policies should follow a positive approach so as to promote shifts in the patterns of production and trade in line with changes in comparative advantage and provide support which is temporary, transparent, linked to the phasing-out of obsolete capacity, and free of protectionist measures against imports. This would create substantial room for the expansion of production and trade of developing countries and economies in transition in those sectors where they had gained comparative advantage. It would also facilitate trade policy reforms in developing countries, as well as the effective implementation of the Uruguay Round Agreements, and lower resistance to further liberalization.

174. Action is called for in three main areas. In the agricultural sector, structural adjustment policies should focus on accommodating increases in import competition which will occur in the longer-term process of liberalization initiated by the Uruguay Round. In the textiles and clothing sector, the objective should be to accelerate the process of liberalization. Delaying the removal of quotas until the very end of the ten-year phase-out period could result in a concentration of structural adjustment problems in the last stage. Finally, developed countries' support of investments abroad and other forms of cross-border production cooperation should focus more on encouraging the relocation of uncompetitive lines of production to developing countries and to economies in transition. This may require refocusing investment guarantee schemes, as well as strengthening the fiscal incentives directed towards this goal. Such policies would help to integrate a greater number of these countries into the process of globalization in line with each country's best ability to produce, while facilitating the industrial upgrading of the home country.

### 2. Trade efficiency

175. Efficiency in the conduct of international trade transactions is essential for the participation of developing countries in international trade. Trade efficiency capacities can be enhanced through improvements in trade-related service infrastructures, such as transport systems, ports and telecommunications, as well as through trade facilitation practices. In addition, recent advances in information technologies offer opportunities for considerably more efficient ways of conducting international trade transactions, including electronic trading.

176. The realization of those opportunities for developing countries will however require appropriate practical support measures on the part of the

international community. Following the United Nations International Symposium on Trade Efficiency (UNISTE, Columbus, Ohio, October 1994), the UNCTAD secretariat has identified three areas where action needs to be taken as a matter of priority: establishing a Trade Efficiency Review Mechanism (TERM); providing the emerging Global Information Infrastructure (GII) with a development dimension; and creating GII subregional nodes to serve the structurally weakest economies, notably in Africa.

(a) *Establishing a Trade Efficiency Review Mechanism (TERM)*

177. TERM has been proposed as a means to address the need to:

(*a*) Maintain awareness, both at the national and international levels, of the constraints that developing countries and small and medium-sized enterprises (SMEs) face for their integration in the post-Uruguay Round trade environment;

(*b*) Evaluate the validity of the policy approaches followed in response to those constraints; and

(*c*) Provide a substantive base for consensus-building for the advancement of trade efficiency.

178. The core of TERM would be the examination of the way in which UNCTAD's recommendations and guidelines for trade efficiency are relevant to local conditions, as well as of the manner and degree of their implementation. The examination would involve a secretariat report—at the request of the Government concerned—and a subsequent intergovernmental discussion. National policy approaches to trade efficiency issues would be reviewed from the perspective of the needs of traders, especially SMEs. Trade efficiency reviews would also look at more general elements of the micro-economic environment in each of the areas of UNCTAD's work in trade efficiency, including relevant governmental policies, institutional structures and business practices, from the standpoint of reduction of barriers to entry to international trade. The review would attempt to quantify the cost of inefficiencies for traders and consumers, thus contributing to greater transparency.

179. Trade efficiency reviews could provide policy makers and decision makers in the public and private sectors in developed countries with an array of signals about a country's strengths and weaknesses in some of the main determinants of trade competitiveness, which may be of particular interest for potential international investors and traders. This could also be of use to multilateral lending organizations such as the World Bank and regional development banks. As a result, TERM could also provide significant additional leverage to poorer countries to attract investment, trade and financial

support for their development process. TERM could furthermore feed UNCTAD's work in trade efficiency in terms of the intergovernmental consensus-building process and the analytical base of its operational activities, as well as supplying valuable information to multilateral and bilateral donors, who have been providing financial support to technical cooperation activities in trade efficiency, about the results of these efforts and priorities for the future.

180. TERM could also provide useful inputs for work in the area of enterprise development. In particular, the evaluation of the conditions in which traders in the developing world and SMEs worldwide have access to international trade would be relevant for the design of policies that aim at fighting exclusion through the encouragement of entrepreneurship, as well as for the activity of non-governmental organizations working with micro-enterprises and the informal sector.

### (b) *Providing the Global Information Infrastructure with a development dimension*

181. The emergence of the Global Information Infrastructure concept (GII) has closely followed that of the National Information Infrastructure (NII) promoted in the United States. GII is predicated upon a rapid deregulation of telecommunications at the world level. The Buenos Aires Declaration adopted at the ITU Conference on Telecommunications for Development (Buenos Aires, April 1994) recalled the importance of telecommunications for development, and UNISTE also called the attention of the international community to the necessity to endow GII with a development dimension at an early stage.

182. The rapid emergence of global information infrastructures is affecting all areas of international trade, either directly, as in the case of services, or indirectly, through shifts in value-creation processes along the trade transaction chain. Information-intensive activities, especially when they are network-based, are becoming increasingly important. Lack of access to relevant trading methods and to up-to-date and affordable information is becoming a major cause of marginalization for many developing countries, especially the least developed ones; in an increasing number of cases, the information "have nots" are also being marginalized in the context of the modern transport, insurance and banking networks.

183. However, this outlook is by no means all bleak. Some characteristics of the current situation make it potentially very promising from the point of view of development:

(*a*) The more advanced countries and enterprises have a vested interest in allowing greater participation in the "advanced sectors" of global trade. For example, electronic commerce (and, more broadly, trade facilitation) allows faster and cheaper transactions, and increased profitability for both exporters and importers. Broader access to information also contributes to increased transparency (and hence efficiency) in international markets. This situation therefore offers significant opportunities for positive-sum processes in which the integration of developing countries and economies in transition in international trade can be pursued as a common objective by the international community. The fact that three recent G.7 meetings (Naples, Brussels and Halifax) have devoted central attention to the issue of Global Information Infrastructure (GII) suggests that considerable investment will be made in this sector over the next decade.

(*b*) What appears to be a major strategic ingredient in international competition, i.e. information technology, happens to be one whose price/power ratio has decreased steadily over the last two decades. This offers unprecedented opportunities to developing countries and countries in transition for leapfrogging to new methods and areas of trade. For instance, such opportunities provide fresh avenues for the diversification (both horizontal and vertical) of commodity-dependent economies. There are also abundant instances of problems of under-utilization of resources as a consequence of inadequate regulations or inadequate practices whose correction requires little or no investment. A careful examination of the effects of telecommunications deregulation on the domestic economies of developing countries could lead to the identification of new, more efficient ways to use existing infrastructures (e.g. copper lines) as well as of avenues likely to generate higher rates of return on new infrastructures (e.g. Low Earth Orbit satellites).

### (c) *The creation of subregional GII nodes*

184. Many poorer developing regions, in particular in the African continent, are still characterized by a remarkably low level of information flow connectivity. This applies both to main telephone lines and specific new services, such as the Internet.

185. As already indicated, some of these problems can be addressed through more efficient use of existing resources, for instance by redesigning regulations. At the same time, being a late starter in a rapidly changing area of technology can be a significant advantage, since it can allow the selection

of state-of-the-art technology at relatively low prices and in a stabilized environment, especially with regard to international norms. As the Global Information Infrastructure takes shape, developing regions with low levels of information flow connectivity could greatly benefit from having access to GII.

186. However, the ability of poorer economies to connect to GII will be a direct function of their ability to identify and generate a local critical mass of users. Hence the necessity, at least in a first stage, to focus on subregional groups of users likely to benefit from the establishment of appropriate communication capabilities, transmit part of these benefits to the rest of their respective national economies, and contribute to the generation of secure and relatively rapid returns for the investors involved.

187. In other words, most developing regions should, in the first stage, focus on establishing GII nodes. A GII node is a subregional "hub" able to provide three major ingredients for the rapid integration of developing countries in GII, namely:

(*a*) A pole for concentration of users' demands to enable them to reach a critical mass that will attract investment and help to lower the price of services offered;

(*b*) A laboratory and information centre where the latest developments regarding the GII can be learned, tested and evaluated with respect to the specific needs and characteristics of local communities, especially smaller firms (including the informal sector) and also rural communities; also where appropriate interfaces and applications are developed, and training is offered in the use of technologies and management techniques;

(*c*) A "telecentre" where the commercial use of information technologies and GII connections contributes to financial support for the provision of GII access to local institutions involved in education, health, environment protection and other socially important activities.

188. Ensuring that GII is really global will require the establishment of "GII nodes" in developing regions. Since 1992, a global network of trade points has been creating electronic trade and information links between developing and developed countries and among developing countries. The consolidation and expansion of this initiative should be a key element of any networking strategy that aims at putting the developing world and industrialized economies on a more equal footing in the field of electronic trade and information flows.

### 3. Measures and actions to address commodity dependence

189. As indicated earlier, developing countries which are heavily dependent on commodity exports face formidable challenges in using international trade as an instrument for promoting their economic growth and sustainable development. These countries share a number of characteristics: lack of significant diversification of their economies; inability to attract sufficient volumes of FDI; and very low levels of social indicators such as life expectancy, infant mortality, per capita availability of doctors, literacy rates, average length of school attendance, and number of telephones per capita. At the same time, their ability to draw development resources from international trade is seriously hampered by their vulnerability to external shocks, and notably to large swings in the prices of the commodities on which they are most highly dependent. For these countries, the key to escaping this "poverty-cum-marginalization trap" lies in the more sustainable and efficient use of their natural resources, by both developing the traditional commodity sectors and building on the existing resource base to develop new exports. Diversification, whether horizontal or vertical or both, of the country's commodity base is likely to play an important role in this process.

190. Concrete policies, measures and actions towards addressing the negative consequences of commodity dependence can be identified in three areas, as discussed below.

#### (a) *Reduction of the instability and risks faced by the commodity-export-dependent developing countries*

191. Although instability is still a major problem for developing-country commodity exporters, it should be recalled that during the 1980s the main problem from which most such exporters suffered was the substantial decline in both nominal and real commodity prices (−2.2 per cent per annum in nominal terms and −5.2 per cent per annum in real terms from 1979-81 to 1991-93). In many cases, these price declines were due in part to excess supply on the markets over sustained periods of time. There are many reasons which can be adduced for such excess supply (including "exit barriers" and the response to the debt-servicing burden), but they are all consistent with the same policy conclusion, namely that producers should consider taking measures to bring supply into equilibrium with demand on a long-term basis, preferably with the cooperation of the consumers.

192. The International Cocoa Agreement 1993 provides an example of how such cooperation might be organized. It contains new economic provisions aimed at achieving equilibrium between supply and demand through adjustments of production and promotion of consumption. The supply ra-

tionalization plan is based on the adoption by the International Cocoa Council of annual forecasts of world production and consumption and the establishment of indicative figures for annual levels of global production necessary to achieve and maintain equilibrium between supply and demand. In the light of these indicative figures, producer member countries draw up a programme for the adjustment of their production and are responsible for the policies and measures applied for the purpose. While this experience is too recent to allow final judgement to be passed on the effectiveness of this approach to stabilization of commodity markets, the introduction of schemes of this sort deserves further serious consideration by the international community. It should be emphasized, however, that, except in the case of a very few commodities, producer rationalization plans depend on consumer cooperation to enhance their chance of success.

193. The past two decades saw a striking increase in the volatility of primary commodity prices, and the recent sharp movements in such diverse commodities as coffee and aluminium suggest that the "quieter" period of the early 1990s may have been an aberration. At the same time, international cooperation to reduce commodity price fluctuations through buffer-stock interventions has collapsed, and arrangements to compensate producing countries for export-earnings losses have either failed to achieve their objectives or have been transformed into conditional devices on which countries are reluctant to draw. Moreover, the application of structural adjustment programmes has led to the dismantling of the instrumentalities of government intervention in commodity markets, particularly marketing boards and stabilization funds, which, for all the inefficiencies associated with them, did provide a measure of stability of revenue to domestic producers.

194. This new context has thrown into sharp relief the need for risk-averse private agents to be able to use market-based instruments to hedge the commodity risk they face. The past decade has seen the development of a number of financial instruments—such as swaps, options and commodity-linked bonds—which can be used for such purposes. However, the development of coherent risk management strategies making safe use of futures and derivatives is neither straightforward nor costless. Moreover, access to these instruments is limited to those entities which meet creditworthiness tests, and they are thus of limited use to individual small producers. On the other hand, hedging substantial revenue flows—as in the case of minerals—raises the requirements as regards the competence of those undertaking the hedging and creates an imperative need for safeguards against mistakes and unauthorized operations.

195. There is therefore an urgent need for both a major programme of technical assistance to help private developing-country producers to make use of these risk-limiting instruments, and a concerted effort of international

cooperation to develop means of overcoming barriers to entry posed by high levels of sovereign risk (for example, by collateralization and guarantee mechanisms).

196. High levels of sovereign risk pose problems not just for access of developing countries to risk management markets, but also for access to credit in general. This adds considerably to the costs of commodity trade, in particular for poorer developing countries: as these countries are perceived as presenting a high risk of default, lenders require high risk premiums. These risk premiums can be considerably reduced if ways are found to provide more security. Such security can be provided if loan reimbursements are tied to the normal commodity export flows of the countries concerned. In many cases, unfortunately, the current international commodity-trade framework does not allow for such ties, particularly because of a lack of securitization facilities. In this light, the promotion of commodity warehouses able to issue warehouse receipts and the development of international facilities which would promote the use of such warehouses require serious attention.

197. In the light of the above, the Conference could consider the following proposals for action aimed at reducing the instability and risks faced by the commodity-export-dependent developing countries:

(*a*) Promotion of exchange of information and voluntary cooperation among producers (as in the Cocoa Agreement) to help bring supply and demand into better balance;

(*b*) Reduction of subsidies for domestic overproduction of agricultural commodities (especially in OECD countries);

(*c*) Notification (as in the subsidies agreements of WTO) of national policies (and those of international financial institutions) regarding commodity production;

(*d*) Reduction of the conditionality of IMF's Compensatory and Contingency Financing Facility (CCFF) and significant expansion of the resources made available to EU's STABEX;

(*e*) Creation of an "international commodity observatory" in UNCTAD to increase market transparency;

(*f*) Establishment of a mechanism in UNCTAD to examine the feasibility of establishing a facility to enhance the availability of securitized commodity finance using warehouse receipts.

### (b) *Promotion of commodity diversification*

198. During the past decade, most developing economies have undertaken a series of economic policy reforms and liberalization measures designed to accelerate the structural adjustment process and domestic growth. However,

the experience of these economies has been extremely varied. Many South-East Asian and Latin American countries have seen their traditional commodity sectors expand rapidly over the past two decades alongside equally rapidly growing new, non-traditional sectors. In contrast, other countries, in particular low-income countries in Africa, have experienced a stagnation of their traditional economic sectors without any progress towards diversification into new ones.

199. This contrasting experience indicates that, to a large extent, the same conditions that allow for sound growth of traditional commodity sectors also permit commodity diversification. Nevertheless, there are specific policies which, within a sound general policy framework, can help the private sector to identify and exploit diversification possibilities; indeed, such specific policies have played a large role in the diversification success of a number of developing countries. Identifying and exploiting diversification opportunities can be "learnt": at the country level, past diversification experience is a good indicator for future experience, and some studies have shown that entrepreneurs use the know-how they gain in the export of fruits or vegetables (often the first "non-traditional" step into the international market) as a springboard for further diversification efforts. Such first efforts also allow the development of a service sector, which facilitates further exports of non-traditional products.

200. Successful diversification appears to a large extent to be related to the flexibility of producers and exporters in identifying and exploiting potentially beneficial market niches. New market opportunities are opening up continuously, not only in the traditional markets in Europe and the United States or in the Middle East, but also in the fast growing economies of Asia and, to some extent, Latin America, which have grown into significant importers of a wide range of commodities.

201. The development of markets for environmentally preferable products may also generate opportunities for successful diversification. Good market information is necessary to identify such opportunities, and a country's producers and exporters need to have the flexibility to react to them. In order to be flexible, they require easy access to production and market information, investment and trade capital, technology, and marketing networks: a sound, stable macro-economic framework, although essential, is clearly not enough. Governments and the international community can play a major role in providing the enabling framework for diversification, which not only helps producers in seizing new market opportunities for traditional commodities, but also enables them to enter into non-traditional commodity production and exports.

202. Experience also shows that successful diversification, as concerns both the development of new commodity exports and the pre-export processing of traditional commodities, is to a large extent correlated to high FDI flows. FDI provides not only the capital but also, perhaps more importantly, the technology and market access required to make a diversification effort successful.

203. Another policy which would stimulate diversification is a more active engagement of Governments, the private sector and the international community in research and development, both for non-traditional export products and for local food crops. Farmers will often be hesitant to shift from a crop they know well into one which is new for them. To stimulate them to innovate, governments should, in addition to undertaking agricultural research, provide farming communities with rural infrastructure and extension services and ensure a regulatory framework which allows for a reliable supply of inputs and good access to credit. These factors played a major role in South-East Asia's success.

204. In many cases, the private sector will be able to generate the necessary finance for diversification activities. Where the private sector is not able to do so because of, for example, a poor credit system or other market failures, alternative sources of finance for diversification would become important. Some countries have successfully employed national diversification funds, with taxes on the main commodity exports used to develop new sectors. An international producer/consumer fund financed by export or import levies, like the one established by one of the earlier coffee agreements, may also be a viable alternative. The World Bank and other financial institutions could contribute by allocating more of their funding to diversification activities and, more generally, to the development of an institutional framework which enables the public and private sector to follow an active diversification strategy.

205. A key element for successful diversification is no doubt an appropriate macro-economic policy framework. However, to enable economic actors to make full use of the possibilities offered by the framework, a number of specific actions are required, both at the national and at the international levels. At the national level, specific actions to stimulate the capacity of public- and private-sector entities to actively identify, publicize and exploit diversification opportunities are needed. At the same time, the international community has to commit itself to not creating undue tariff and non-tariff barriers against new commodity exports. With this objective in view, the Conference could take the following actions:

(*a*) Call upon Governments, within the framework of WTO, to determine the modalities and set a timetable for the elaboration of pre-

cise proposals for the reduction of tariff escalation on processed primary commodities and for the elimination or reduction of non-tariff barriers to market access for these commodities;

(*b*) Propose concrete measures to enhance the access to finance for diversification of low-income countries, either through existing instruments or the establishment of a new instrument;

(*c*) Call for increased support for ITC and other relevant organizations, specifically for their work in the development of products and markets likely to enhance the diversification of developing economies.

### (c) *The efficient management of natural resources*

206. The survival of human and other life systems is a universal goal that underlies efforts—increasingly articulated since the United Nations Conference on Environment and Development (UNCED)—to address concerns about the impact of economic growth on the natural environment in the context of sustainable development. Such concerns arise notably with regard to the management of natural resources, since both commodity and industrial production activities affect the natural resource base. However, since production is primarily driven by demand, the level, pattern and pace of consumption activity—and thus population growth and lifestyles—will play a major role in determining the feasibility of sustainable natural resource use.

207. Accordingly, changing consumption patterns and demand towards environmentally preferable products and improving production techniques—making them both cleaner and "leaner"—are very important requirements for natural resource conservation. Meeting this requirement is facilitated by the process of globalization in so far as the latter entails a faster and more widespread diffusion of the relevant conservation technology.

208. To the extent that environmental costs (and benefits) are not internalized in the prices of products, the changes required in production and consumption patterns will not come about. This has been recognized by several developing countries through the creation of taxes on traffic in urban areas and by some OECD countries in their application of, for example, energy taxes. The principle could be extended more broadly into the commodities field by international cooperation to create framework agreements within which incentives would be made available to commodity producers to use "cleaner and leaner" production techniques; such agreements, known as "International Commodity-Related Environmental Agreements" (ICREAs), merit serious further consideration.

209. In the context of global sustainable development, the efficient management of natural resources means ensuring that the natural resource base is used so as to produce socially optimum quantities of various commodities in perpetuity with no irreversible damage to the physical environment and without imposing significant risks on future generations. The process of liberalization is creating challenges to such management because the emphasis on private-sector activity, and the concomitant retreat of government, is entailing a shift in time preference towards the short term. Nevertheless, this opens up possibilities for the design and implementation of a multitude of national and international policies which would promote sustainable and efficient use of natural resources, as well as maintaining and improving environmental quality.

210. At the national level, the specific content of natural resource management will vary between countries according to their level of development, including their financial and institutional capacities, and the relative importance of natural resources in their economies. More and more developing countries are under pressure to allow both exploitation of their natural resources and the deterioration of their environments in order to enhance export earnings. For such countries, the challenge is to use the natural resource base judiciously and in a proactive manner—for example so as to promote diversification and multiply economic opportunities, *inter alia* by creating developmental linkages between the natural resource sector and other sectors of the economy, to protect the environment so as to help improve the quality of life and ensure the sustainability of development, and, in the case of non-renewable resources, to ensure their replacement with lasting capital that can provide the basis for future economic development.

211. Action is needed at the national level, and especially in developing countries, to improve information about the natural resource base and to ensure that this information is properly integrated with development planning and national accounting processes; to capture resource rents and to manage resource revenue so as to maintain economic stability in the short term while generating income for the longer term; to improve the capacity of government to undertake the latter actions; and to monitor and regulate, in a participatory framework, the impact of economic activity on the national resource base. At the international level, action is required to establish a multilateral cooperative approach to deal with externalities that compromise the sustainability of natural resources, to encourage the recycling of resource-based products, and to improve the competitiveness and promote the use of natural products with environmental advantages. Specifically, it is proposed that the Conference take the following actions:

(*a*) Promote the negotiation of International Commodity-Related Environmental Agreements as an element of a multilateral cooperative approach to deal with environmental externalities;

(*b*) Promote the establishment of a voluntary trust fund to encourage the production and trade of environmentally advantageous natural products;

(*c*) Urge the establishment of a window in the Global Environmental Facility to deal with environmental problem areas such as the rehabilitation of mining sites and mineral processing facilities.

### C. New and emerging issues

212. Even before the agreements negotiated in the Uruguay Round had been accepted at the Marrakesh Ministerial Meeting, efforts were being made to seek international agreement on the future work programme of the new WTO as a component of the final "package". Agreement was reached to establish a committee to deal with trade and environment; the other proposals, upon which agreement was not reached, are laid out in the Concluding Remarks of the Chairman of the Marrakesh Ministerial Meeting. Of these issues, the relationships between trade and (i) environment, (ii) investment, (iii) competition policy and (iv) labour rights can be seen as components in the overall pursuit of deeper integration and of the "level playing-field" described in the preceding chapter.

213. More recently, OECD adopted a report at the Ministerial level setting out a programme for action for the post-Uruguay Round trading system. As mentioned in chapter I, this programme is aimed at maintaining the momentum towards freer trade based on the concepts of deeper integration and "contestability of markets", i.e. ensuring that foreign firms are provided with access and opportunities to operate that are equivalent to those of domestic firms, with a view to ensuring that national markets are open to global competition. This emphasis on firms rather than products reflects the realities of globalized production of goods and services, where the value of sales of foreign affiliates far exceeds that of exports. It would also seem to build upon some of the new elements introduced into the multilateral trading system by the GATS through the definition of trade in services to include the notion that the sales of foreign-controlled firms on the domestic market of the host country can be considered as "exports" and that foreign Governments have acquired rights with respect to the treatment of the subsidiaries of "their" firms, and conversely, the possibility that host developing countries can seek commitments from [illegible] enterprises.

214. Such initiatives are clearly related to the preparation of the agenda for the first Ministerial Meeting of WTO, to be held in Singapore in late 1996, which can be expected to address the issues contained in the Marrakesh list to the extent that a consensus on how to deal with these issues can emerge. The process of building consensus in favour of negotiating new

multilateral disciplines in these areas would have to take account of the existing international framework of obligations, including bilateral investment treaties and cooperation agreements on competition policy. Furthermore, various formulae have been devised for addressing these issues in the context of regional and subregional agreements, which, as mentioned below, are often seen as laboratories for the eventual development of multilateral disciplines in new areas. The need for specific trade-related disciplines in these areas to reinforce the disciplines of existing multilateral trade agreements would also be an important consideration.

215. Most importantly, it should be recognized that these proposals for new multilateral disciplines are aspects of the broader question of the implications of a further extension of multilateral trade obligations into additional areas of domestic policy, including those pertaining to property rights. Such an extension would imply that to a large extent global governance would be carried out within the framework of trade agreements. This, at the moment, is a hotly contested issue, with some developing countries indicating strong opposition to extending multilateral trade disciplines to non-trade areas. Furthermore, most of the initiatives on new and emerging issues to date emanate from forums in which developing countries are absent or only partially represented. Thus, the challenge facing the consensus-building process is to ensure that the development implications of various approaches and scenarios are fully understood, so that the interests of developing countries can be adequately taken into account.

### 1. Competition policy

216. The implementation of market-oriented economic reforms, including deregulation, price liberalization, privatization and liberalization of trade and foreign direct investment have led to an emerging consensus worldwide on the importance of the role of competition in increasing efficiency in resource allocation. As a result, a rapidly growing number of countries (all OECD countries, as well as many developing countries and economies in transition) have adopted competition legislation and created a national competition agency as an effective tool of competition policy.

217. There has been a process of convergence in the objectives and application of national competition policies, although there continue to be significant differences among such policies. A significant degree of convergence exists in prohibiting cartels and collusive tendering, but most national competition policies still do not apply to restrictive business practices (RBPs) which solely affect foreign markets, such as export cartels. In such cases, it is often difficult or impossible for the country whose markets are affected (particularly if it has limited resources) to take effective remedial action

without full cooperation from the authorities of the country where the RBP originates. Difficulties may also be faced where the authorities in a country seek to gather evidence or enforce their laws in respect of RBPs practised by foreign investors.

218. There is growing recognition that, in an increasingly globalized world economy, national competition policies need to be complemented by action at the international level to protect and promote the vitality of competition in the global market. The specific objectives of such international action would be to strengthen consultations and cooperation among competition authorities, to encourage better mutual understanding and possible convergence of national competition policies, to ensure that trade obligations and concessions are not frustrated by private anti-competitive practices, to bring trade rules more into line with competition principles, to reduce trade tensions among Governments, as well as tensions from enforcement of competition laws overseas, and to address competition issues arising in relation to foreign investors. This could be done within the framework of the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices.

219. As competition, trade and investment policies are bound to be brought even closer together in the future, in addition to the mechanisms available under the Set of Equitable Principles and Rules governing RBPs, new mechanisms to coordinate approaches to the interface between trade, investment and competition policies may have to be conceived. Strengthening of the multilateral trade agreements through the incorporation of additional legally binding competition policy provisions may also be needed. It should be noted that several of the Uruguay Round Agreements recognize that competition policies are relevant to the effective implementation of multilateral trade obligations. The importance of collaboration to deal with anti-competitive practices has been recognized in the GATS; the Agreement on Safeguards prohibits parties from encouraging or supporting private measures which could have the effect of voluntary export restraints; and the Agreement on Trade-Related Aspects of Intellectual Property Rights recognizes that action may be necessary to prevent the abuse of intellectual property rights to restrain competition. As noted in chapter I above, the TRIMs Agreement will be reviewed before the end of 1999 to determine whether it should be complemented by provisions on competition and investment policy.

220. The Third United Nations Conference to Review All Aspects of the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices (November 1995) recommended "the continuation of the important and useful work programme within UNCTAD's intergovernmental machinery that addresses competition law and policy issues". It might be appropriate for UNCTAD to embark on preparatory work

to clarify the issues related to the interface between competition and trade policy and to help build the consensus needed to integrate competition principles into the international trading system.

## 2. Trade and investment

221. Consideration of investment is already included in the future work programme of WTO. The TRIMs Agreement provides for a review of its possible extension to include investment and competition policies within five years of WTO's entry into force. This decision to treat investment and competition in parallel flows from the recognition that many conditions are imposed on foreign investors with the objective of pre-empting anti-competitive practices which would otherwise be difficult to contain within the framework of national competition law, as well as from the recognition that competition policy may interfere with investment flows in certain cases but may also be necessary to ensure that foreign investors obtain effective national treatment when granted.

222. The GATS provides a framework to negotiate commitments on investment within multilateral trade obligations. Commitments on investment (i.e. commercial presence) can be traded off against reciprocal commitments with respect to other service sectors, other modes of supply (e.g. movement of natural persons), or even, in a broader round of negotiations, access to markets for goods. In accordance with the objectives of the GATS, however, progressive liberalization negotiations are aimed at promoting the interests of all participants on a mutually advantageous basis and securing an overall balance of rights and obligations, while respecting national policy objectives. The GATS also recognizes the right of developing countries to seek commitments from enterprises with respect to access to technology and to distribution channels and information networks in return for market access granted under the Agreement (Articles IV and XIX). All GATS commitments, including those relating to investment, are covered by the unconditional MFN clause.

223. The interface between trade and investment covers a spectrum of issues ranging from those which are closely "trade-related" (e.g. export performance requirements) to "pure" investment issues such as taxation, transfer pricing practices, the extent of the legitimate exercise of extraterritorial jurisdiction, home countries' obligations with respect to the behaviour of firms, and compensation for expropriation. Any efforts towards building a consensus for multilateral action in this area, regardless of the forum chosen, will also have to take account of the fact that investment policies in developing countries are conceived as part of a strategy supportive of transfer of technology, industrialization and better standards of living and are designed

to enable the developing countries not only to attract investment but also to ensure that it is channelled to activities that have been given priority in the national economic and social development strategy.

### 3. Trade and environment

224. Much of the international debate on trade and environment has focused on three basic issues: (*a*) the linkages between environmental policies and international competitiveness; (*b*) the use of trade measures for environmental purposes; and (*c*) the appropriateness of harmonizing environmental policies across countries.

225. On the first issue, concern is sometimes expressed in developed countries that trade and investment may be lost to countries which have less stringent environmental standards, or that competitiveness considerations may discourage the implementation of more stringent domestic environmental requirements. At the same time, in developing countries the main question raised is how environmental protection impinges on their trade and development.

226. Available empirical evidence indicates that the competitiveness effects of environmental policies have, so far, not been significant on developed countries. As far as developing countries are concerned, the competitiveness effects of external environmental policies, standards and regulations could become more significant for small-scale firms and for firms in sectors such as textiles, footwear, electronics and furniture, as the need to comply with environmental requirements would frequently result in increased production costs in relation to competitors. There is a degree of vulnerability of exports from developing countries to environmental regulations of developed countries. Moreover, where developing countries lack the infrastructure or technology to comply with increasingly complex environmental requirements, new technical barriers to trade may arise. However, environmental policies may also have positive competitiveness effects and create trading opportunities; and in any case attempts may be made to mitigate competitiveness effects by policies at the national and international levels.

227. It is increasingly recognized that "positive measures" (rather than trade-restrictive measures) should be implemented to support the developing countries in their efforts to internalize environmental costs and to assist them in meeting internationally agreed targets in the context of Multilateral Environmental Agreements (MEAs). The Commission on Sustainable Development (CSD), at its third session held in May 1995, invited UNCTAD and other relevant international organizations to identify such positive measures. The UNCTAD Ad Hoc Working Group on Trade, Environment and Devel-

opment, meeting in November 1995, recognized that positive measures such as improved market access, improved access to finance, transition mechanisms, access to and transfer of technology, capacity-building and special provisions for small firms and for some sectors are effective instruments in supporting developing countries and countries in transition in their efforts to meet the objectives of sustainable development.

228. The Ad Hoc Working Group undertook a preliminary analysis of the trade and competitiveness effects of MEAs, in particular the Montreal Protocol on Substances that Deplete the Ozone Layer, the Basel Convention on Transboundary Movements of Hazardous Waste and the Convention on Trade in Endangered Species (CITES). It recognized that these effects are different for each agreement and may change as a result of dynamic factors such as the rate of economic growth, the availability of environmentally friendly technologies and substitutes, amendments to the agreements, and the timely availability of finance. It also felt that interim assessments of MEAs may offer a useful opportunity to take account of such changes. The Group recommended further analytical and empirical work on the trade and competitiveness effects of MEAs.

229. The Working Group furthermore recognized that positive measures could be valuable in assisting developing countries to meet multilaterally agreed targets in keeping with the principle of common but differentiated responsibility. In this context, the Group discussed incentives that encourage trade in environmentally friendly substitutes, voluntary mechanisms in respect of foreign direct investment and technology transfer, and market-based instruments.

230. Building on the results of the Ad Hoc Working Group on Trade, Environment and Development, including its recommendations for future UNCTAD activities, the Conference could recommend that activities on positive measures should focus on: (1) building consensus on principles and propositions to better integrate trade and environment policies within the context of sustainable development; and (2) proposing policy measures aimed at alleviating the potentially negative trade and competitiveness effects of environmental policies.

231. Principles and propositions could aim at ensuring appropriate transparency of newly emerging environmental policy measures with possible trade effects, including voluntary measures such as eco-labelling, *inter alia* by seeking inputs from interested countries; at creating mechanisms to help establish an appropriate balance between the environmental benefits and possible trade and development effects of environmental policy measures; and at further developing concepts such as equivalencies and mutual recognition in the framework of specific environmental policy instruments.

232. The issue of positive measures is closely linked with the broader question of national policies and strategies for sustainable development and the kind of international cooperation which can provide a favourable environment for their success. The Conference could examine how to promote the systematic integration of environmental aspects in ongoing international debates on measures to promote investment in infrastructure, on specific measures for SMEs and specific sectors, and on measures for improvements in trade policies, such as promotion of export diversification and elimination of trade-distortive subsidies.

233. The second issue is concerned with the circumstances under which the use of trade measures for the enforcement of environmental policy objectives is justified and consistent with international trading rules, while remaining conducive to economic development. Here the Ad Hoc Working Group on Trade, Environment and Development endorsed the commitment to Agenda 21 and Principle 12 of the Rio Declaration that ''unilateral actions to deal with environmental challenges outside the jurisdiction of the importing country should be avoided. Environmental measures to address transboundary and global problems should as far as possible be based on international consensus''. These principles also extend to unilateral import restrictions based on PPM (process and production methods)-based requirements.

234. With regard to Multilateral Environmental Agreements (MEAs), in a number of cases provisions have been included for the use of trade measures, and these provisions have played a role in addressing global environmental problems. However, the appropriateness of using trade measures in MEAs must be analysed on a case-by-case basis. This analysis should consider, among other issues, the necessity and effectiveness of such trade measures.

235. The third issue, namely the appropriateness of harmonizing environmental policies, is closely related to the increased pace of globalization and liberalization in the world economy. The concern of some Governments here is whether differences in environmental standards among countries, especially between developing and developed countries, result in unfair trade advantages and therefore call for a degree of harmonization. Consensus has emerged that the case for the use of trade measures to offset differences in costs arising from differences in environmental standards is weak, both from an economic and an environmental point of view.

236. In this context, the Ad Hoc Working Group on Trade, Environment and Development firmly rejected demands sometimes made to introduce so-called green countervailing duties or other protectionist or WTO-

inconsistent trade measures to compensate for negative competitiveness effects, whether real or perceived, of environmental policies.

237. There is, however, continued debate on whether border tax adjustments should be allowed to compensate for differences in process-related standards and for differences in the use of non-physically incorporated inputs, such as energy. While border tax adjustment is permitted for product taxes, consensus appears to be growing in support of the view that such adjustments may not be of significant environmental benefit if applied to processes or non-physically incorporated inputs and that they could serve protectionist purposes. The Ad Hoc Working Group on Trade and Environment, at its final session, recommended a number of future UNCTAD activities within the theme "trade, environment and development".

### 4. Regionalism and the new and emerging issues

238. The negotiation of new regional trade agreements and the extension of existing ones, which took place in parallel to the Uruguay Round, have resulted in a further liberalization of trade among the countries concerned, which include the majority of WTO members. Regional agreements in certain cases have responded to the perception that countries' trade and economic relations had intensified to such an extent that more detailed and extensive disciplines than those included in GATT were required to govern their mutual trade and economic relations. While the extension of multilateral disciplines resulted in many cases in the multilateral obligations overtaking the regional disciplines, many regional agreements include policy areas which are not covered by the disciplines of the multilateral trade agreements, such as investment policy, labour rights, competition policy and environment.

239. Such measures pose important issues for the development of the multilateral system. In some cases, multilateral rule-making may be able to draw on the experiences of regional groupings, using them as "laboratories" for testing approaches. In other cases, such rule-making will necessitate adjustment in regional approaches which are incompatible with the objective of an open multilateral trading system and have adverse implications for the trade and development of third countries.

240. More generally, as regionalism proliferates and expands into new policy areas, the question arises whether regional integration could undermine the multilateral trading system or whether regional and multilateral approaches to integration at regional levels will rather be complementary, enhancing the prospects for effective multilateral rule-making and further global trade liberalization.

241. The impact of regional integration arrangements on trade and development depends not only on rule-making, but perhaps even more so on the way in which rules are implemented and on the nature and actual behaviour of regional groupings. In this context, the outward orientation of the regional groupings, whereby the net effect is trade and investment creation, is essential if adverse effects of such groupings on the trade of third countries are to be avoided. Comprehensive assessments at the international level of the economic implications of integration arrangements and their actions can ensure that due account is taken of concerns over adverse impacts on trade of third countries, and in particular of developing countries and countries in transition outside particular integration groupings. Such assessments would also contribute to the development of multilateral approaches to the issues arising from integration measures. The UNCTAD Trade and Development Board already offers a forum where evaluations of significant new developments in regional integration can be carried out. A proposal has recently been introduced to the effect that a WTO committee be established to deal with regional trading agreements in a more comprehensive manner.

### D. Promoting complementarity between UNCTAD and WTO

242. The functional complementarity between UNCTAD and WTO has been recognized both by the Trade and Development Board and by the WTO's Preparatory Committee, as well as by the United Nations General Assembly. This consensus creates the premise for constructive cooperation within the broader framework of relations between the United Nations and WTO, as agreed by their executive heads. In fact, the distinct but complementary functions of the two institutions should make it possible for the trade-related development concerns of the developing countries, and also those of the countries in transition, to be addressed in a more comprehensive and balanced manner.

243. This report has identified many such concerns resulting from the process of integration of developing countries and countries in transition into the post-Uruguay Round international trading system. In particular, support will be required to enable these countries to fulfil their obligations and to participate actively in the current activities of WTO and in the related negotiating processes. Prospective members of WTO will need help in acceding to membership.

244. A working relationship between UNCTAD and WTO could evolve in the following substantive areas:

(*a*) The implications of the Uruguay Round Agreements, particularly as regards new trading opportunities for developing countries and

countries in transition arising from the implementation process, and assistance to these countries to take full advantage of such opportunities;

(*b*) Specific problems and challenges faced by the least developed and net-food-importing developing countries and by countries in transition in their integration into the international trading system;

(*c*) Trade in services, including measures to assist developing countries to benefit from the GATS, as well as issues to be addressed in future negotiations (e.g. data on measures affecting trade in specific services sectors, safeguards, subsidies, government procurement, etc.);

(*d*) Trade and environment;

(*e*) New and emerging issues on the international trade agenda, in particular trade and competition and trade and investment;

(*f*) Technical cooperation, particularly relating to:

(i) Strengthening of the capacity of developing countries and countries in transition to participate effectively in the international trading system;

(ii) Accession to WTO;

(iii) Capacity-building to deal with new issues on the international trade agenda;

(*g*) Continuation of the joint responsibility for the operation of the International Trade Centre UNCTAD/WTO.

245. Consideration could also be given to the holding of a regular review by the competent intergovernmental bodies of UNCTAD and WTO of issues relating to their mutual cooperation.

246. In this context, new and expanded cooperation between UNCTAD and WTO is under way in the framework of the general arrangement for cooperation between the United Nations and WTO, as agreed by the executive heads of the two Organizations in September 1995. In particular, the Director-General of WTO and the Secretary-General of UNCTAD have agreed: (*a*) to hold meetings, chaired jointly by them, every six months, beginning in mid-January 1996; (*b*) to improve the working relationship between the two organizations at all levels in such areas as research, trade and investment, trade and competition, trade and environment, and trade and development; and (*c*) to work for greater complementarity in technical cooperation—not only between UNCTAD, WTO and ITC, but also with other agencies, whether in the United Nations system, the Bretton Woods institutions, or regional bodies—in order to improve coordination across the board and make better use of resources. The executive heads have stressed their complete agreement on the high priority that must be given to Africa in the cooperative work of their two organizations.

*Chapter III*

# PROMOTING ENTERPRISE DEVELOPMENT AND COMPETITIVENESS IN DEVELOPING COUNTRIES AND ECONOMIES IN TRANSITION

## Introduction

247. The role of enterprises in development is receiving increased attention from policy makers in all countries in the 1990s. Enterprises are the basic building blocks of an economy, the entrepreneurial engine of the dynamic processes of capital accumulation, growth and development. This has been a text book truism for many years, but only recently has it found wide expression in the policy approach to major issues.

248. The reasons for contemporary interest in enterprise development are many, and are as diverse as countries are different:

(a) *Poverty*. Micro-enterprises are increasingly seen as the means to empower the poor and the disadvantaged.

(b) *Employment*. Small and medium-sized enterprises are seen as major contributors to job creation, even in the mature industrial economies facing structural unemployment.

(c) *Adjustment*. The considerable experience now gained from structural adjustment programmes in many developing countries suggests that the supply response of enterprises is essential to the success of structural adjustment measures.

(d) *Transition*. The nurturing of a whole new class of entrepreneurs and wealth-seekers is fundamental to the reconstruction of the former socialist economies in line with market principles.

(e) *Privatization*. Fiscal burdens, coupled with the need to promote entrepreneurship and economic efficiency, have prompted the transfer of enterprises from the public to the private sector in developing and developed countries.

(f) *Competitiveness.* The best industrial exporters among developing countries have relied on enterprise development strategies, including linkages with foreign investors and TNCs.

(g) *Competition.* The trend towards a borderless world is increasing competition everywhere and bringing enterprise issues within the ambit of international discussion and negotiation. These issues include competition policy, the harmonization of national standards of all kinds and access to global networks.

249. This chapter examines this new policy setting and outlines main considerations for the shaping of more coherent national and international strategies for enterprise development in the current context of liberalization and globalization.

## A. The enterprise sector in developing countries and economies in transition

### 1. Main features

250. Over the past decade, nearly all developing countries and economies in transition have enacted an array of institutional and economic reforms to liberalize the environment for enterprise activity. These efforts are beginning to bear fruit, but not without a degree of restructuring and dislocation.

251. The liberalization of domestic markets is encouraging greater private sector activity generally. In some cases, the response has been impressive: double-digit annual growth rates in private output in several countries in Asia and Latin America for instance. At the same time, greater freedom for entrepreneurial activity has also given rise, in some instances, to extortionate pricing, gangsterism and lawlessness. Liberalization of the trade regime has meant that many enterprises have had to close down, but the sustained growth in exports of developing countries in recent years is due largely to private enterprises, domestic and foreign. Newly privatized or incorporated enterprises have been stimulated to rationalize their production methods, but they have also shed workers and the pool of unemployed has consequently grown in many countries.

252. In many developing countries, market reforms have been implemented in the context of structural adjustment programmes. Although the stabilization objectives of these programmes have met with some success, the persistence of low-growth conditions has discouraged capital outlays on modernization of equipment, capacity expansion and exploration of new business opportunities. The cutback in public expenditures in many develop-

ing countries has also prevented investment in the basic physical, institutional and standard scientific and technological infrastructures that local and foreign-owned enterprises require in order to be able to operate profitably.

253. The supply response has been particularly weak in Africa. A major inhibiting factor is the scarcity of enterprises in general, and their low initial levels of capabilities in particular. Because of low entrepreneurial capabilities, enterprises, even if otherwise efficient producers, lack the know-how to tap emerging market opportunities. The problem is aggravated when infrastructure and institutional support is limited, as is the case in many of the least developed countries.

254. In the economies in transition, market implementation has been slowed by the necessity to overhaul institutions with considerable historical, economic and social-political dominance. The production base is outmoded in many economies, owing to the earlier orientation towards satisfying military rather than consumer needs, and the emphasis on meeting quantitative targets without regard to quality standards.

255. Public enterprises, generally, have faced more difficulty than the private sector in adapting to market reforms. In part, this is because governments in economies in transition have laid greater stress on improving financial performance rather than efficiency. Reduction of the size of the public enterprise sector has received greater attention than the need to improve management. At the same time, success in cutting the relative size of the sector in developing countries has been limited.

256. Overall, enterprises in developing countries and economies in transition will need to continue to restructure and improve their competitiveness if they are to meet successfully the challenge of competing imports or to penetrate foreign markets. Production in many countries has typically consisted of the domestic replication of foreign products for local markets that are not large enough to permit operation in efficiently scaled plants at full capacity. Costs tend to be excessive and quality standards barely sufficient to meet the requirements of local markets. In the context of liberalization and globalization, firms will need to react flexibly and quickly to a dynamic setting with new technologies, changing market demands and the entry of new competitors. World markets have exacting standards as regards packaging, finishing, styling and technical specifications that firms in developing countries and economies in transition must be prepared to meet.

257. Foreign direct investment and other types of foreign collaboration can help improve competitiveness, particularly in the manufacturing sector, and almost all developing countries and economies in transition are able to point to at least a few such projects. However, many countries have been disappointed in the interest so far shown by foreign enterprises—as inves-

tors, joint venture partners, technology suppliers, franchisers, trading companies, sales agents and buyers—in potential ventures. Although countries have liberalized their framework for foreign investment, foreign partners are often not enticed because of the high transaction costs and risks inherent in investing in, or in collaborating with, weak and inexperienced local partners in many developing countries. Nevertheless, starting from a small base, there has been a rapid growth in international subcontracting with the small-scale enterprise sector, mainly in East and South Asia, North Africa and parts of Latin America and the Caribbean. FDI and joint ventures have, meanwhile, grown rapidly in a number of more advanced or large developing countries. Where a dynamic, indigenous enterprise sector is not yet entrenched—particularly in sub-Saharan Africa and in the economies in transition—prospects for increased foreign investment will largely depend on the pace and success of enterprise development.

258. National policies can also help foster the emergence of a dynamic enterprise sector, since market forces alone may not provide sufficient incentive to private enterprises to invest or innovate in a developing or transitional economic environment. Factors which markets tend to ignore include: the presence of economies of scale; risky and unpredictable learning sequences whose costs differ according to the technologies and which cannot be financed by firms themselves or by capital markets; and various spill-overs (such as interlinked cost reductions to other firms which are not reflected in current market prices). Under these conditions, market-friendly policies can help improve the allocative potential of markets while generating new skills and capabilities, and can increase private profitability while lowering the risk of investing. That is by no means a simple or straightforward task but, as the successful East Asian experience attests, it is possible to influence the market-place while taking account of price signals in setting priorities and mapping out strategies and, in so doing, serve the long-term interests of the enterprise sector and the economy as a whole.

### 2. The East Asian experiences

259. There can be no across-the-board extrapolation of the East Asian experiences to the rest of the world, but they do contain several features that seem relevant to enterprise development anywhere. To begin with, the governments of the region pursued sound macro-economic and exchange rate policies that ensured the stability necessary for profitable investment, high saving and rapid economic growth. Savings were channelled through the banking system to the enterprise sector, which relied extensively on debt-financing. State-subsidized credit was made conditional on competitive performance criteria. The availability of credit allowed those with management

experience, often acquired from employment in TNC affiliates, to set up their own SMEs.

260. Many East Asian countries relied on protectionist trade policies in order to provide scope for technological learning in their infant industries. However, protection was selective, staggered and (starting in the 1980s) time-bound. Also, emphasis was placed on the establishment of local suppliers, many of which were SMEs linked to the larger firms through subcontracting arrangements. The supply of technical know-how associated with these inter-firm relationships contributed to technological learning. Moreover, in some countries the existence of a dense network of relationships with local suppliers, which emerged in the 1980s, gave exporters of more modern products an advantage in being able to respond quickly and flexibly to shifting demand patterns.

261. The pattern of importing technology and capital varied between economies. Whereas the Republic of Korea, following Japan, was selective in permitting foreign investment, Taiwan Province of China did not discriminate between foreign and domestic investment except in a few individual sectors. Singapore relied on FDI as a means of importing technology, as did several other ASEAN countries. In all instances, however, government policies were designed to enhance the learning potential of domestic producers. There was a continuing emphasis on education at all levels, and on training. Public and private investment was made in the creation of technical institutes and vocational training schools, which helped train and supply middle-level technicians and foremen. Owing to the high rate of growth in real wages, families had incentives and the means to invest in the education of their children. Through a system of tax incentives and levies, governments also promoted in-house training in domestic firms which supplemented the training provided by affiliates of TNCs. In some countries, such as Singapore, governments prevailed upon and cooperated with TNCs to establish training facilities in selected industries.

262. Ample resources were also poured into the funding of R & D which was encouraged by the granting of tax advantages and other incentives. Promotional policies favoured competitiveness by distinguishing between infant, mature and declining industries. Sectors with the potential for high productivity growth were encouraged to export, *inter alia*, through exemptions from tariffs, preferential interest rates and tax write-offs. Governments invested heavily in creating the necessary infrastructure in the form of modern telecommunications systems, cheap and reliable electrical power, roads and transportation facilities and ready-to-use factory sites. This investment in modern infrastructure has helped offset the declining importance of labour-cost advantages in the face of new competition from other low-cost producers since the 1980s.

263. Firms responded to the opportunities created by this favourable environment in a number of ways. Initial emphasis was on learning-by-doing and applying imported technologies for production in the domestic market. Gradually, this led to the acquisition of the capacity to make minor changes and improvements in productive facilities, and to realise minor innovations through reverse engineering. All this strengthened their ability to respond to growing competition in world markets, producing for specialized product niches and increasingly more sophisticated knowledge-intensive products. Experience in servicing export markets provided the necessary technical and marketing expertise even to invest abroad, both in less developed and in industrialized countries.

264. The conditions leading to these favourable outcomes do not prevail in all countries, nor do all of them have the option for an orderly sequencing of liberalization in today's globalizing world economy. Furthermore, the legal framework has been changed by the Uruguay Round. Nevertheless, the East Asian experience does suggest the main elements of a national strategy for enterprise development: the creation of an enabling environment; provision of market-friendly incentives for national enterprise development and business support services; and the fostering of backward and forward linkages between firms, and horizontal linkages between firms and other institutions, particularly science and technology institutes.

## B. National and regional policies for enterprise development and competitiveness

### 1. The enabling environment

265. The creation of an enabling environment for entrepreneurship and enterprise activity is one of the most important roles of public policy intervention, including government measures and international financial support of such measures. A favourable or enabling environment is not by itself sufficient to ensure the emergence of a dynamic enterprise sector, but it is a highly desirable and often necessary condition for enterprise activity. It requires, primarily, sound and consistent economic policies to foster business confidence and investment, mobilize savings and facilitate structural adjustment. Also essential are the institutional, legal and commercial frameworks that define the market conditions for transacting business.

266. An important aspect of the enabling environment is the quality of the working relationship between government and the private sector. All governments regulate and promote enterprises in one way or another, and *how* this is done often matters more than *why*. Quite often, well-intentioned poli-

cies to correct market failures have the opposite effect; on the other hand, interventionist policies can be market-friendly when formulated in a transparent and non-discretionary manner, in cooperation with the constituency most affected—the private sector.

(a) *Fostering business confidence and investment*

267. Most developing countries and economies in transition have already put in place policies to liberalize and improve their national environment for enterprise activity. Such efforts include, among others, macro-economic stabilization programmes which seek to maintain and/or restore price stability and economic growth. They also include significant liberalization of FDI frameworks and the implementation of trade-policy reforms. These involve the reduction or elimination of licensing and quantitative restrictions, high and extremely differentiated tariff rates, export taxes and burdensome bureaucratic requirements and paperwork.

268. Industrial reforms include measures to reduce the number of inefficient and loss-making public enterprises through privatization and other public enterprise reforms, reduction of entry and exit requirements on private enterprises, easing of price controls and removal of soft budget constraints. Such measures make it easier for investment to take place, eliminate obstacles to doing business and put management of enterprises in the hands of professionals whose performance is made subject to the test of the market. Combined with stabilization measures and trade policy concerns, they increase the rewards to productive entrepreneurial activity—or activity ''subject to verification by the market''—as distinct from speculation and rent-seeking.

269. Liberalization inevitably involves a process of restructuring and dislocation. When inherently inefficient activities are wound up, resources are released for more productive purposes; however, when potentially competitive activities fail, resources are simply left unemployed. As it is difficult to choose winners, it is important that all enterprises be allowed an opportunity to restructure and upgrade their physical and human capital. As already noted, many countries undergoing structural adjustment programmes have experienced a generally weak supplier response. In such instances, governments may need to go beyond market liberalizing reforms and consider more proactive, supply-side policies to facilitate enterprise restructuring, particularly in industries that appear to have medium-term technological and competitive potential. Such policies would need to be market-friendly, and avoid the pitfalls frequently associated with industrial policy. They should also receive the support of international institutions, by ensuring that structural adjustment programmes include strong measures in favour of enterprise development.

270. Competition policies can help strike a balance between, and create a level playing-field for, small and large enterprises, fostering enterprises that are capable of standing up to international competition, and permitting enterprises to take advantage of large size and opportunities to cooperate with other firms in R & D and other technical (cooperation) activities. The enforcement of competition laws takes on increased relevance in economies in transition and more generally wherever the public interest needs to be protected from restrictive business practices and other potential abuses of monopoly power arising from privatization of large enterprises.

271. Enterprise development also requires a transparent, predictable and supportive commercial and legal framework. Although such a framework exists in many developing countries, it still needs to be put in place in most economies in transition, in which there are no traditional legal institutions for enforcing contracts, incorporating enterprises, protecting creditors against defaults, preventing business fraud, etc., and where it is sometimes necessary to reinforce the public's perception of the legitimacy of private economic activity. Adequate protection of intangible assets such as patents and copyrights is an inherent element in the creation of a hospitable environment for investment and for the encouragement of technical progress.

### (b) *Strengthening government-business relationships*

272. The involvement of governments in enterprise development varies greatly from country to country. In all instances, it is the vocation of governments and donors to act as catalytic agents, doing only what enterprises and markets cannot do themselves. In practice, however, cumbersome policies, rigid measures and overly bureaucratic rules often tend to crowd out the private sector and de facto circumscribe, or even supplant, the responsibility of enterprises to manage their own establishment, operation and technological advance. It is therefore essential that all strategies for enterprise development be formulated in close consultation with the private sector. Whenever possible, enterprises should pay for the services that they receive from the government, to ensure that these are demand-oriented and self-terminating when no longer needed.

273. The quality of the working relationship between government and the private sector is particularly important for building skills, technological and infrastructure development and the promotion of inter-firm linkages.

274. Various mechanisms have been established by governments for the promotion of policy dialogues between different economic actors—workers, entrepreneurs, investors, bankers, consumers, large and small enterprises, and elements of the civil society—and between them and the government in

order to balance their different "claims" and to reconcile them with the objectives of government policy. The deliberative or consultative councils established in Japan and the Republic of Korea have served as useful forums to exchange information and to obtain inputs for policy-making from the private sector on such matters as market trends, technological developments, regulations and potential business plans—the latter on both a functional (e.g. pollution, finance or taxation issues) and an industry-specific or sectoral (e.g. automobiles or chemicals) basis. Government-business consultative committees have also been established in Malaysia, Thailand and other countries. An essential condition for the success of such bodies is an efficient and reputable bureaucracy that commands the confidence of all the parties concerned.

275. Consultative mechanisms help to strengthen the quality of government-business cooperation. They establish the broad parameters for business cooperation, allowing firms to concentrate on market competition and not worry about trying to curry favour with the government. They also serve as proto-democratic institutions, providing direct channels to governmental authorities for businesses, labour, consumers and academia.

## 2. Formulating national strategies for enterprise development

276. A favourable enabling environment provides the necessary backdrop for policies directed more specifically at fostering enterprise development. In many countries that have succeeded in fostering a strong enterprise sector these policies were brought together in a coherent enterprise development strategy. At UNCTAD IX, developing countries that so wish might declare their intention to formulate or update national enterprise development strategies, with help from the international community as required. The following paragraphs discuss some of the more important elements that would need to be included in such strategies, focusing in particular on micro-enterprises and small and medium-sized enterprises, which are of central importance in most developing countries.

### (a) *Elements of an enterprise development strategy*

277. The enterprise sector is highly diverse, with different growth potentials, structures and problems, depending on the particular industrial sector and economy. Typically, it consists of a network of micro, small and medium-sized enterprises (SMEs), big locally-owned companies, affiliates or partners of transnational corporations (TNCs) and State-owned or parastatal companies operating in a market system with freedom for private entrepreneurship.

278. The focus of an enterprise development strategy should be primarily on SMEs, as these constitute the vast majority of enterprises in most countries, developed or developing. Of course, particular country situations and national objectives may warrant additional foci (e.g. privatization of large parastatals in some economies in transition).

(i) *Mobilizing entrepreneurial resources*

279. Entrepreneurs are economic risk-takers—individuals who can perceive a profitable opportunity and are willing to take risks in pursuit of it. They also need business acumen, but the ability to organize a business can be learnt, and it can of course improve with experience, for few entrepreneurs succeed in their first venture. All societies have men and women who are inherently entrepreneurial, although these capabilities may not always be put to productive use if economic conditions and the business environment are not favourable, as can be the case in developing countries and economies in transition.

280. Experience suggests that programmes to identify and develop the entrepreneurial skills of particular individuals and groups can play an important role in mobilizing entrepreneurial resources. When carefully designed and implemented, these programmes can bring economic and social benefits that greatly exceed their cost. Typically, the programmes are targeted, with candidates undergoing self-selection procedures or behavioural testing before qualifying for training. The programmes then focus on building business skills and aptitude, by providing instruction and counselling related to activities ranging from the original screening of the project to the actual operation of an enterprise. Successful entrepreneurship development programmes ensure that the demand for training and advisory services is a genuine response to the opportunities of a competitive economy. They also avoid creating new windows for privileged access to subsidized credit and other forms of special treatment.

281. Entrepreneurship training can be an important component of an enterprise development strategy, particularly when adapted to target a wide variety of groups such as high school and university graduates, middle-level employees of large enterprises (including parastatals), redeployed workers from the public and private sectors, school leavers, women and the poor.

(ii) *Supporting micro-enterprises in the informal sector*

282. Micro-enterprises that function outside the official regulatory framework contribute substantially to employment and productivity. It is estimated that the informal sector accounts for over 50 per cent of the labour force and some 20 per cent of GDP in many African, and a few Latin

American, countries. The informal sector thrives because of its responsiveness to market forces; ease of entry and exit makes it a magnet for entrepreneurs from all sections of society, including women, the poor and minority groups.

283. The competitive environment of the informal sector is a good breeding ground for entrepreneurs, but it cannot provide the infrastructure and support services that enterprises need to expand and grow. The informal sector offers little recourse when business deals are not honoured; moneylenders are often the only ready source of credit. Micro-enterprises that limit business contacts to close acquaintances and relatives stay small. An accessible and predictable legal framework could help entrepreneurs escape the constraints imposed by informality, while also helping to eliminate some of the barriers that prevent graduation to a larger scale of production. Successful government policies to facilitate the development of enterprises that originate in the informal sector include measures to lower the costs of compliance with regulations and provision of support services to micro-enterprises, which encourage them to strengthen their linkages with formal markets and institutions and eventually to formalize their participation therein.

284. Experience suggests that programmes to help develop micro-enterprises in the informal sector—typically owned by women, rural residents and the urban poor—increase employment and incomes. By raising the incomes of the poor above marginal subsistence, they also boost the demand for products and services of all domestic enterprises. By legalizing the ownership of assets and bringing them into the production system, the formalization of the informal sector is also wealth-creating. The most effective micro-enterprise development programmes are locally run and focused on specific objectives. The beneficiaries are many, as the individual assistance offered is often modest (e.g. small loans of US$ 1,000 or less are often all that is required).

(iii) *Assisting small and medium-size enterprises*

285. Small and medium-size enterprises play a crucial role in industrial, technological and trade development, and are an essential part of the "supply response" to the pressures and opportunities of globalization. SMEs are, by definition, relatively more adaptable, flexible and innovative than large enterprises. By working together in cooperative arrangements with other SMEs and/or with larger firms, they can become specialized suppliers of goods and services and achieve scale economies associated with such specialization. By investing in multi-purpose equipment together with other co-operating firms, they can also achieve the benefits of flexible specialization. However, being small has its drawbacks, particularly in terms of access to

essential inputs, such as support services, credit and finance, and business information.

(iv) *Access to support services*

286. There is need for a framework of proactive policies designed to expand the demand for a broad range of "producer" or support services that enterprises use insufficiently, either because the market, such as it is, does not supply them or because they are unaware of their importance in improving performance. Support services cover such areas as project execution, pre-investment studies, management consulting, production control, product development, marketing, engineering design, quality control, laboratory testing, packaging, accounting, insurance, banking, legal services, repair, maintenance and hire of equipment, data management, computer and software, transport etc.

287. Programme coverage is always likely to be limited in comparison with the number of potential users. Additionally, to be cost-effective, programmes need to target firms with a likelihood of success. In order to ensure that it is genuinely needed and in line with market demand the cost of a service should be, at least partly, borne by the recipient firms. The success of any one programme depends on the functioning of many; since SMEs typically need multiple support services, programmes need to be integrated and organized so as to fill a wide gamut of needs (e.g. human resources management, advice on organizational improvements, design, quality assurance and marketing, etc). Even the most successful programmes show results in terms of contributions to growth and exports only in the medium to longer-term but, when they do appear, the dividends can be quite sizeable.

288. The role of government is not necessarily to provide the advisory, consultancy or technical assistance services, but rather to stimulate the private sector and provide some financial support, leaving intermediaries to actually deliver the services. Entities most commonly providing such services might be business associations established by groups of enterprises; professional societies in fields such as accounting or engineering; ad hoc organizations established jointly by government agencies and business groups; and international organizations. One advantage in relying on third parties, rather than civil servants, for the supply of services to the enterprise sector is that they are more likely to be in tune with market demand and the needs of industry users, and are generally able to deliver higher-quality services with less delay, greater flexibility and lower cost. Universities have also fulfilled a useful role in assisting industry, primarily when specialized bodies have been created that are organizationally and financially independent of the university.

289. In order to stimulate the supply of domestic services, governments have used various instruments. These include direct financial support (e.g. financial assistance to overcome a shortage of venture capital); fiscal and credit incentives (e.g. exemption from import duties on equipment, tax exemptions on royalties, accelerated depreciation schemes or subsidized loans); and deregulation (e.g. modification of the regulatory system to reduce or remove the boundaries between different services). Other components of the strategy to promote the supply of such services include incentives for the "externalization" of locked-in service activities, and the establishment of service centres or training centres aimed at teaching national staff to render producer services.

(v) *Access to finance*

290. Access to credit and equity capital is important for all enterprises, but particularly for SMEs. Financial institutions tend to favour large enterprises at the expense of SMEs owing, for example, to difficulties in assessing SME risks or the relatively higher administrative costs of lending to them. These policies are not helped by poorly documented loan requests from SMEs caused, for example, by internal difficulties of SMEs such as lack of skills in assessment of input costs, marketing and the preparation of proper accounts and a business plan. Often compounding the problem is the lack of adequate information and understanding of borrowing procedures in the formal financial sector.

291. One approach which has proved highly successful in Asia is the establishment of specialized credit institutions for SMEs, including loan guarantee programmes for commercial banks lending to SMEs. Community-based banks have also been effective, tapping informal networks of personal contacts that help to reduce the risk and cost of lending to SMEs. Likewise, linking the information network of the informal sector, such as thrift societies, with the lending network of the formal sector can help to improve information flows. The experience of specialized small-scale lending to low-income groups, for example of Grameen Bank, shows that group solidarity can serve effectively as a form of lending collateral.

292. Organized stock markets are lacking in much of Africa and the economies in transition. While international development agencies have established venture capital facilities in a few countries, these initiatives are by no means adequate. The feasibility of regional venture capital facilities deserves consideration by international and regional financial institutions.

293. The international community provides financial support for SME development, particularly for low-income countries, in several ways. One is through loans and equity financing, as in the case of IFC. Various developed-country bilateral agencies also provide such financing in partner-

ship arrangements linked to the internationalization of their own enterprises. However, it is not clear to what extent SMEs in developing countries and countries in transition have benefited from such support. The World Bank provided loans through the formal banking sector for SME development projects in developing countries from 1973 until 1991, when the traditional SME lending programme was discontinued for a variety of reasons, including the mixed performance of the projects.

294. However, a small number of "disguised" SME loans, i.e. loans incorporated in other projects, remain. Recently, a micro-lending programme has been created to channel micro-loans to the "poorest of the poor" through grass-roots organizations. So far US$ 200 million have been pledged by the World Bank, regional development banks and bilateral agencies for the Consultative Group to Assist the Poorest, which will mobilize resources and coordinate lending. Another form of support or "the next frontier in SME lending", as the World Bank puts it, is to help governments establish well-designed, market-based technical assistance or support services for the development of SME capabilities, including in the area of finance. These efforts need to be strengthened through technical cooperation support from organizations such as UNCTAD, UNIDO and the World Bank.

(vi) *Access to information networks*

295. SMEs can broaden their markets through cooperative arrangements that disseminate information on local or regional products and services. Privately managed programmes with public support are better at sustaining up-to-date information flows to local SMEs. The success of these efforts depends on the ability of locally based trade and professional associations, NGOs, and grass-roots organizations—sometimes working with governments and international organizations—to develop demand-driven mechanisms for delivering these services.

296. Private schemes that bring together SMEs for joint leasing, purchase, or time-sharing of equipment can increase efficiency and economies of scale. Such cooperative arrangements can help smaller firms to find inputs from local and regional large-scale manufacturers. These efforts can be supported through data banks that help entrepreneurs locate equipment or make licensing arrangements for imported technologies.

(vii) *Building technological capabilities at the enterprise level*

297. The ability of a country to sustain rapid economic growth in the long run is highly dependent on the effectiveness with which its institutions and policies support the technological transformation and innovativeness of its enterprises. While most developing countries and economies in transition

have science and technology policies and institutions, these are, for the most part, poorly adapted to meeting the needs of industry. They need to focus not only on scientific research but, more importantly, on the diffusion of technology, and they also need to create horizontal linkages between the various actors involved in the diffusion process.

298. In formulating science and technology policies it is essential to have a clear picture of the network of agents that interact to generate, produce and disseminate technological innovations. This is because technological innovation does not always occur through scientific research. Many innovations involve incremental improvements in technical performance, product quality or product design, or simply learning how to manufacture an existing product. The design for a new variant of a particular product may come from the R & D department of a firm which is the buyer of that product rather than from the manufacturing firm itself. Improvements in quality control procedures could be worked out entirely by the firm's engineering department; alternatively, the firm could receive technical assistance from its machinery supplier, from a State-run industrial technology centre or an engineering consultancy centre, or a combination of the above. In other words, there is a larger network of agents, together with science and technology institutions and policies, that influence enterprises' innovative behaviour and competitive performance. Technology-based incubators, working closely with universities and research institutions, are an important instrument for commercializing R & D and for exploiting knowledge spillover arising from location and proximity.

299. Innovation at the enterprise level involves the introduction of a product or a process that is new to the firm, irrespective of whether it is new to the country or to the world as a whole. This means that the orientation of science and technology policies should not be limited to activities or institutions associated with the most advanced scientific research at the frontier of knowledge but must be more broadly focused on factors and policies that influence the formation of technological capabilities. Policies should facilitate interaction among and between both users and producers of knowledge, including with enterprises and other agents from outside the country.

300. The aim of policy intervention in the R & D systems of economies in transition differs somewhat from that facing developing countries. The economies in transition have inherited a critical mass of scientists and engineers able to carry out R & D even if it is not all relevant to contemporary civilian needs. Nevertheless, in both groups of countries, policies have centred on steps to commercialize a significant part of the activities of publicly funded R & D institutes. This serves to increase the amount of resources available to them for R & D and to improve their effectiveness and relevance to the needs of industry by subjecting a greater part of their activity

to the market test. More generally, there is a tendency to move away from pure academic research, without totally abandoning it, and towards the provision of trouble-shooting, engineering, product development and similar services to enterprises. These services, together with the establishment of industrial standards, quality controls and certification and testing, all contribute to the development and greater internationalization of their industrial sectors.

(viii) *Encouraging inter-firm linkages*

301. Owing to changes in market demand associated with new systems of globalized production, inter-firm relationships have changed dramatically in recent decades. Industrial firms all over the world are finding it necessary to cooperate both vertically with suppliers and customers and horizontally with erstwhile competitors, i.e. to fortify and rely increasingly on relationships with other firms, both domestically and abroad.

302. In today's market-place, both speed and flexibility in production have become imperative. The availability of forward, backward and horizontal linkages allows firms to make more cost-effective decisions in terms of choosing whether to produce a particular input within the firm or to source it externally. These firms are finding that such cooperation may be necessary in order to lower their costs and to become more innovative. However, trust is an important factor in establishing effective inter-firm networks and cooperation.

303. As traditional determinants of competitiveness are being eroded, technical change and innovation have emerged as dominant factors contributing to competitiveness of firms in today's market-place. Experience from industrialized countries has shown that inter-firm relationships play a critical role in the innovation process. Inter-firm linkages make possible the learning needed for cooperation. Product innovation is highly dependent on feedback of user-experiences, as the involvement of suppliers in manufacturing processes gives them an insight into the use of the equipment they produce, which in turn facilitates process innovation.

304. There are many different types of inter-firm linkages, including formal networks for knowledge exchange (such as relations with universities, centres of higher learning, R & D institutes, government laboratories), informal relations among firms (both domestic firms and TNCs) and with suppliers, and other social relations that affect learning. Communication and interaction between firms with different capabilities and complementarities are a very important source of creativity and innovation. Interaction with foreign affiliates operating in an economy and with foreign firms through outward FDI can be a particularly important source of learning.

305. In addition to the kinds of policies and institutions for promoting enterprise capabilities already discussed, governments can promote inter-firm collaboration in R & D and other areas by facilitating the transfer of technology between firms and assisting in the formation of national and international strategic alliances, collaboration agreements, subcontracting or OEM (original equipment manufacturing) arrangements and/or technological partnerships, including the participation of universities and local governments. They can also help to promote collaboration in R & D among firms and research institutes and to commercialize R & D by the establishment of technology-based incubators.

(ix) *Regional cooperation*

306. A useful complement to national efforts is regional cooperation, which can enhance the access of SMEs to information, technology, finance, technical know-how and skills. Regional efforts have been successful in Asia and should be drawn on in framing similar approaches in Africa.

307. A recent example is the ASEAN Programme of Action on SME Development, which provides for the networking of national support agencies to exchange information and to pool resources and expertise for SME development in the region. Areas for cooperation include the possibility of establishing new financing mechanisms for SME development; joint training programmes to upgrade the capabilities of entrepreneurs, managers and technical workers; joint technological development in particular industries; and cooperation in marketing and in collective promotion efforts in the form of joint trade exhibitions for particular products.

308. Proposals are also under consideration in APEC for cooperation on access to information (private/business sector networking and electronic commerce) and finance (APEC venture capital investment scheme to facilitate the globalization of SMEs in the region). In the area of human resources development and technology, an APEC Centre for Technology and Training for SMEs has been established.

309. TECHNONET Asia, set up in the early 1970s, is an outgrowth of various donor-supported projects for SME development. It groups together 14 participating organizations—principally SME support agencies—from 12 countries in Asia and the Pacific. Its programmes are primarily supported by international and bilateral donors and focus on four main areas: dissemination of industrial information; provision of industrial extension services; facilitation of technology transfer or sharing; and development of indigenous entrepreneurs and enterprises. The establishment of similar schemes in other regions deserves consideration.

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310. The elements of a strategy for enterprise development outlined above will have practical application only to the extent that they can be adapted to a variety of different country contexts and, also, integrated with other overriding national policy imperatives, such as poverty alleviation and structural change. Moreover, successful implementation will require that the orientation of enterprise development is towards tapping the potential opportunities presented by the larger globalizing and liberalizing trends in the world economy. Furthermore, international support, ranging from technical assistance to financing, will be required, particularly for the least developed countries. Finally, any strategy needs to take account of larger systemic issues, which may need to be addressed through multilateral action, aimed at creating an appropriate international framework that provides opportunities for firms from all countries.

## C. Facilitating enterprise operations in a global economy: the need for international action

311. National strategies for enterprise development need to be supported by actions at the international level. These actions can take two forms, as part of a global strategy for enterprise development.

### 1. Global supporting activities

#### (a) *Fielding of enterprise development missions, especially in LDCs*

312. While the vast majority of enterprises in any country are small, they can develop into dynamic and technologically sophisticated companies, and a significant and increasing number also internationalize. The process is not automatic, nor should it be. Entrepreneurship involves a high degree of risk and many start-up enterprises fail within the initial three years of operation, in all economies. This is in part a matter of market selection, and is necessary for the preservation of a nation's long-term industrial strength. At the same time, enterprise survival rates during incubation and in later years are not insensitive to the overall business climate. It is also true that the lifespan of enterprises is longer—and their growth in size and activities over the life-cycle is greater—in countries where infrastructure, market institutions and the regulatory environment (e.g. property, liability, bankruptcy and monopoly laws) are more highly developed. In developing countries, especially LDCs, where these conditions vary considerably and are generally less hospitable, policies and technical cooperation programmes must address a very wide set of country-specific issues for effectively tackling enterprise development.

313. There is no shortage of policy approaches and technical cooperation programmes for enterprise development. At the macro level, the World Bank, IFC and other institutions provide advice on implementing an enabling environment for enterprise development, usually focusing on policy and institutional reforms, and the removal of obstacles to the conduct of business. At the micro level, the focus is on providing support and training to enterprises of all kinds, ranging from traditional cottage industry, rural and urban micro-enterprises and SMEs, agro-business and, of course, large-scale industry, including firms with overseas facilities. Not all these elements are in place in all countries, and when global support is forthcoming it is not always country-specific.

314. There is thus a need to field enterprise development missions, especially in LDCs, with a view to formulating country-specific strategies and implementing integrated technical cooperation programmes for enterprise development. In countries where structural adjustment programmes are under way, the enterprise development missions could consider ways to facilitate efforts by enterprises to respond to adjustment measures (see next section).

315. These integrated programmes should ensure continuity of global supporting activities across the enterprise development continuum, as firms grow from micro- to medium-sized enterprises. As previously noted, enterprise development has an important global dimension. New technologies have encouraged transnational corporations to globalize their production and disperse activities geographically, to take advantage of local conditions. With appropriate support, small businesses in developing countries can be players in the world market-place by linking with foreign companies as suppliers, service firms and joint venture partners. An example of such support is EMPRETEC 21, a new programme developed by UNCTAD to provide SMEs with an integrated package of services to enhance their entrepreneurial drive, their technological capability, their eco-efficiency and their ability to export. The programme builds on the highly successful EMPRETEC programme (jointly implemented by UNCTAD and DDSMS), which has benefited over 2,500 entrepreneurs in Africa and Latin America over a six-year period.

316. The relevant international institutions should come together to formulate a more systematic approach to the multiple needs of low-income countries in a number of areas, including *inter alia*: provision of policy advice or technical expertise in the creation of favourable framework and market conditions, especially a sound policy and commercial framework for the development of well-functioning institutions and markets; enterprise development, particularly SMEs; strengthening of institutions for providing market-based support services to SMEs, and the networking of support agencies at both regional and interregional levels; development of the insti-

tutional requirements of an effective policy dialogue between the government and private-sector organizations, including SME associations; and networking of firms of developed countries with those of developing countries and countries in transition in order to promote mutually beneficial forms of enterprise, technological and trade development.

(b) *Ensuring that structural adjustment programmes include strong measures in favour of enterprise development*

317. Programmes of structural adjustment in low-income countries were initially introduced in response to severe external shocks and in order to correct policy distortions which were deemed to impede the development process. They were designed as a finite process of policy reform, supported by external financial assistance. The overall expectation was that macroeconomic stability would provide an environment in which privatization and the freeing up of markets would unleash the forces of growth.

318. Experience to date has not borne out these expectations. While the precise pathology varies considerably among countries, it would appear that, owing to structural features and the embryonic stage of the development of markets, managers and entrepreneurs, as well as the lack of a reasonable period for adjustment by enterprises, the expected response of producers to liberalization and deregulation has often failed to materialize. Indeed, the African experience suggests that too rapid exposure to import competition may have deterred some firms from making the kind of restructuring investments that take time to yield results.

319. Failure of liberalization to bring forth adequate responses by producers, difficulties in reforming public sector revenue systems and the lack of sufficient external support have meant that budget deficits have had to be dealt with primarily through cut-backs in expenditure. A major new effort needs to be set in motion to strengthen structural adjustment by addressing, in consultation with the private sector, the need to include strong supply-side developmental measures for enterprise development. These measures should enhance the supply response to other adjustment measures and promote employment. Adequate attention should be given to the link between producer services and adjustment in manufacturing and agricultural sectors.

(c) *Activities aimed at enhancing enterprise competitiveness*

(i) *Capacity building for producer services*

320. The support of the international community is required to assist developing countries and countries in transition in formulating development

strategies encompassing the aspects described above. Sectoral and country-specific studies examining these issues should provide these countries with useful inputs and guidelines in considering policy options for capacity building for producer services. The technical assistance being carried out in the field of services has concentrated on developing an awareness of the importance of the producer service sector, including as a means for promoting SMEs. In a number of countries—for example, China—questionnaires submitted to manufacturing firms were used as a basis for measuring the quality of service inputs and assessing service needs. Such an approach, originally tested in Latin America, has been used in several developing countries and would be of particular relevance to countries in transition.

321. The Coordinated African Programme of Assistance on Services (CAPAS) aims to provide the participating countries with the tools to assess their national economic policies in the area of services. In the process, the programme has also stressed the development of an endogenous analytical capacity not limited to the government machinery but involving also the national academic and consulting communities and representative organizations from the private sector. Where requested, technical assistance should be provided with respect to the reform and liberalization of international transactions in services and the strengthening of the domestic capacity of developing countries in the area of services, so that their enterprises may benefit from the increasing participation of foreign service providers in the domestic economy through investment, cross-border trade, and other modes of service delivery.

(ii) *Capacity building in trade efficiency*

322. Most advanced technologies can successfully contribute to the trade competitiveness of developing countries' enterprises if an appropriate strategy for the mobilization of local and international resources is adopted. Examples of successful programmes in the area of trade facilitation include Customs automation (ASYCUDA) and the Global Trade Point Network (GTPNet), a worldwide system providing trade- and investment-related information and transactional tools, especially targeted at SMEs.

323. The application of information technologies has made a significant contribution to the improvement of customs revenues in a context of tariffs reduction. It is helping to reduce corruption and to simplify trade, particularly for SMEs. Similarly, the main users and beneficiaries of a Trade Point are small and medium-sized enterprises. Such programmes are practical tools which can contribute to reducing the cost of integration in global trade. International support will now be particularly important for the provision and improvement of local infrastructure such as national and subregional

Internet servers, which will allow an even greater degree of interactivity and flexibility in exchanges among Trade Points and their business users.

324. One proposal which could usefully receive attention from the Conference would be to enhance the capacity of Trade Points to function as information and training centres for SMEs with regard to new trading opportunities and requirements. Thanks to the links between Trade Points and local business communities, such an effort could assist the private sector in adapting to, and benefiting from, Uruguay Round commitments.

(iii) *Science, technology and innovation policy reviews*

325. Developing countries and countries in transition require considerable assistance from the international community in framing technology strategies to meet their particular needs. Building on experience in developed countries, UNCTAD, in liaison with the Commission on Science and Technology for Development, has been called upon to work on science, technology and innovation policy reviews adapted to the needs of developing countries and countries in transition (pursuant to Economic and Social Council resolution E/1995/4 of 19 July 1995). The purpose of science, technology and innovation policy reviews is to help participating developing countries and economies in transition evaluate the contribution of science and technology policies and institutions to the development of their enterprises—including their international competitiveness—in order to strengthen the relevance of such policies and institutions to the needs of the industrial sector. By enriching knowledge of how these policies are designed and applied, the reviews will help other developing countries and economies in transition to improve their own policies, while at the same time opening opportunities for greater international cooperation.

(d) *Diffusing "best support practices" for enterprise development*

326. Identification of "best practices" regarding market-based governmental support for enterprise development may be facilitated through exchanges of lessons learned from country experiences. The UNCTAD Ad Hoc Working Group on the Role of Enterprises in Development highlighted a number of "best practices" gleaned from country studies and exchanges. Among them were measures to:

(*a*) Facilitate business start-ups or the "formalization" of small businesses, by providing incentives (for example, in the form of access to finance and other benefits) for small business registration, as in Ecuador, and simplified tax payment procedures for small businesses in the form of a small lump-sum tax without the need

for the filing of tax returns or the preparation of accounts, as in India;

(*b*) Produce skills to meet the needs of the job market through a system which combines apprenticeship, theoretical education at specialized institutions and on-the-job training on the shop floor, as in Germany, or through demand-driven, market-related job training programmes, as in several Latin American countries;

(*c*) Promote export development by helping first-time exporters to set up an export business, as in Canada and Norway, by providing an integrated package of services in one-stop shops, as in the United Kingdom, as well as by supporting mutually beneficial enterprise, technological and trade development through the twinning of firms of cooperating countries, such as Germany and India;

(*d*) Reduce the risk and cost of lending to SMEs or to enhance such lending by building up networks of personal contacts (which can also help to mobilize savings) through community-based banks, as in Bangladesh and Nigeria; by providing specialized or policy-based lending, as in Japan and the Republic of Korea; by using mutual credit guarantee societies or insurance schemes funded by banks and small enterprises, as in France; and by creating an export credit facility which provides credit to SMEs which are subcontractors of larger exporting firms, as in Mexico.

327. The identification and exchanges of "best practices" regarding policy and institutional support for enterprise development can benefit from cooperation among developing countries and cooperation between them and developed countries, including through the networking of support agencies and the establishment of procedures for exchanges based on particular areas and on agreed standards for information exchange. There is considerable scope for further work to build on the results achieved so far by the Ad Hoc Working Group on the Role of Enterprises in Development in order to identify policy elements for national action and international cooperation.

### 2. Issues for intergovernmental action

328. By its very nature, the process of liberalization and globalization of the world economy brings with it the internationalization of enterprises—large and small, from all groups of countries—through trade, investment, licensing and a range of other modalities. This means, in turn, that an increasing number of issues related to enterprises take on an international dimension as well, including, for example, questions related to product liability, consumer protection, competition policy, restrictive business practices, access to R & D funds, illicit payments, accounting standards, environmental

regulations, professional qualifications, access to closed user-group networks, the operation of stock markets, taxation, transfer pricing, bankruptcy, protection of intellectual property rights and responsibilities of banks for their branches abroad. What all of these issues share is recognition that the nature of the liberalization and globalization process increasingly reduces the ability of individual countries to tackle them effectively unilaterally.

329. As globalization proceeds, the need for multilateral approaches to issues connected with the internationalization of enterprises will become more pressing. Action will not necessarily take the form of comprehensive multilateral negotiation on enterprise internationalization—a micro-economic Uruguay Round, so to speak. Rather, it may well be a piecemeal process in which issues that are particularly pressing will be dealt with, one at a time, by various competent international organizations.

330. Be that as it may, the nature of the globalization process necessarily puts the implications for national regulatory frameworks of enterprise internationalization on the agenda. UNCTAD can play a central role in helping to understand better this aspect of the globalization process, its implications for development, the role of enterprises in it, the range of issues this brings to the international agenda and the policy options that governments may need to consider in this respect. In particular, UNCTAD can play a role in identifying and building consensus on the most urgent enterprise internationalization issues that require multilateral attention. In so doing, UNCTAD would, of course, pay special attention to the requirements of enterprises from developing countries, especially the LDCs. When UNCTAD was called upon to do just this in the area of trade some 25 years ago, it developed the GSP. In today's world economy, the challenge is much broader and, if anything, more important.

### 3. Establishment of a Global Advisory Committee

331. The policy dialogue process operating within UNCTAD should be inclusive and open-ended, seeking to involve not only all governments but also a representative range of those non-governmental actors playing an increasingly important role worldwide in many aspects of public life, nationally and internationally. NGOs are today active in many areas of interest to UNCTAD: for instance, development *per se*, the environment, human rights (including labour and gender issues), technology issues, and disarmament. Profit-orientated business groups, representing national and regional sectors, are likewise also actors of growing significance for an international institution such as UNCTAD. How to harness the energies, fresh ideas, and grassroots links of NGOs and companies, individually or collectively, so as to inject elements of the civil society into the work of UNCTAD and provide a

"quick response" two-way channel of information on developmental questions is an issue for the Conference to consider.

332. NGOs, too, are being affected by the globalization process, and their reaction to it will increasingly influence the public policy responses. In addition, they are important sources of interdisciplinary experience and expertise which can help policy makers see the broader implications of their decisions. In turn, NGOs can play a valuable role in helping translate and interpret to the people concerned those actions and decisions that further the cause of development. To provide a forum for this interchange between the civil society worldwide and international organizations, a Global Advisory Committee consisting of representatives of business, trade unions, academia and other relevant parties might be established to advise UNCTAD and other international organizations concerned on all matters related to enterprise development.

*Chapter IV*

# FUTURE WORK OF UNCTAD IN ACCORDANCE WITH ITS MANDATE; INSTITUTIONAL IMPLICATIONS

## Some personal reflections

333. The backdrop to the effort to define the work of UNCTAD on the threshold of the next millennium is nothing less than the profound historic movement that is at last giving substance to a vision which began with the European age of maritime exploration five centuries ago, but which the Phoenicians, Vikings, Chinese and other great trading peoples also dreamed of: the unification of markets and of economic space on a planetary dimension. This is an extremely complex phenomenon, fraught with contrasts and contradictions.

334. With the fall of ideological walls, convergence has taken the place of confrontation. Institutions such as IMF, the World Bank, GATT/WTO—long seen as relevant to only one of the blocs of a divided world—are becoming the backbone of a single, generally accepted world economic system. On the other hand, competition and trade frictions, once moderated by national barriers and regulations, have been exacerbated to a point never seen before. Eventually, that might jeopardize or reverse the progress achieved so far.

335. Globalization is, paradoxically, a powerful force for both integration and marginalization. It promises, for the first time in history, to bring fully into active participation in the world economy two billion women and men in the fast-growing developing countries. But in contrast, hundreds of millions of other individuals fear that the same forces threaten to shut them out—perhaps forever—from the promise of prosperity. They are the unemployed or low-wage earners in sectors of industrial economies that have been lagging behind in the process of change. They are, too, the poor and jobless in many developing countries that depend on a few commodities barely touched, if at all, by globalization and liberalization.

336. In this intervening period between the old and the new, it is no wonder, as Gramsci would say, that all kinds of morbid symptoms come to the surface, that fear and insecurity thrive alongside hope and bright expectations. This is the very essence of the crisis that currently overshadows international relations and fuels a permanent urge for reform, overall and everywhere: throughout the United Nations system, in the Bretton Woods institutions and, last but not least, in UNCTAD.

337. We in UNCTAD are of course part of the more general crisis of the United Nations in the sense that we are affected by a widespread fatigue with the conference system. But there is also a distinct specificity in what could be described as UNCTAD's identity crisis. UNCTAD was created in the mid-1960s in order to change the *status quo—a status quo* that was then synonymous with the economic institutions of Bretton Woods and GATT. UNCTAD was expected to develop a better and alternative system of economic relations—the New International Economic Order. Its inspiration was rooted in ethics and justice: the conviction that only a radically changed system could open the way to the development of all mankind. Development was the indispensable precondition for closing the ever-widening gap between the happy and affluent few and the miserable and destitute many.

338. And change did indeed come about, but not at all in the manner envisaged a generation ago. Rather than being the result of a formalized process of multilateral negotiations among States, it has been the product of profound globalizing forces. Largely beyond the control of governments, production and distribution would come to be organized not in a centralized and interventionist way by the State but in accordance with decentralized and private-sector patterns coordinated by the market.

339. UNCTAD has not been alien to these transformations. Indeed, it has given a significant impulse to them, through its efforts to help developing countries both adopt more efficient development policies and see the need to use international trade as a tool for integration, growth and development. The organization was itself one of the early examples of *aggiornamento* when, at UNCTAD VIII four years ago, it redesigned its role and machinery in order to better respond to the requirements of the age. Setting aside what had come to be regarded as a too rigid and at times confrontational group system of negotiation, UNCTAD shifted the accent to the new notion of partnership and cooperation for development. Partnership was made possible not so much on the basis of a conceptual platform—some blueprint or programme of action adopted by governments to restructure economic relations—but rather in response to the exigencies imposed by a complex and emerging reality. The persistence of extreme poverty and growing inequality, together with the proliferating risks of marginalization and envi-

ronmental destruction, rendered cooperation a *sine qua non* for meeting the challenge of globalization.

340. From Cartagena onwards, a shared perception of the nature of prevailing economic conditions has begun to assert itself. Several features of this perception are discernible:

It dismisses one-sided explanations and divisive recipes;

It attempts to grasp all the elements and complexities of development and to interweave them in a balanced and comprehensive tapestry;

It recognizes the market and private initiative as the dynamic agents of an expanding economy, without losing sight of the determining influence of good governance and an efficient but reduced State;

It rightly lays stress on the ultimate responsibility of each society, and of each government, to create the political and macro-economic conditions for stability and progress.

341. At the same time, the new outlook has continued to insist that the success or failure of domestic efforts often depends on the external economic environment. The better to succeed, those efforts need an international system capable of accelerating growth in a stable and sustainable way worldwide. The external environment must also provide countries with open and competitive access to the basic elements of sustainable development, i.e. markets, financing, investment, technology and financial and technical assistance. These elements constitute, as always, the fundamental priorities of UNCTAD's work.

342. To understand and explain how these elements will interact in an increasingly globalized economy will remain the central aim of a research and analytical effort which is, generally speaking, directed more at the forest than at the trees. Analysis and conceptual explanation are not, however, ends in themselves. They should always be viewed from the perspective of their usefulness in helping to promote development in a fair, sustainable and harmonious way.

343. To that end, we need to concentrate on what is realistic and practical: not on over-ambitious and remote grand designs, but on precise and limited objectives within our reach. As Alexander Herzen said (*apud* Sir Isaiah Berlin):

> . . . a goal which is infinitely remote is no goal, only . . . a deception; a goal must be closer—at the very least the labourer's wage, or pleasure in work performed.

344. This is why analysis has to be action-oriented in two complementary directions. The first is the preparation of the multilateral agenda for future negotiations on trade, investment, competition, environment and technology. Here, the specific contribution of UNCTAD will be to provide a development perspective, one which will balance the overall picture by taking into account the needs and interests of countries at different stages of integration into the world economy. This work will be pursued in a cooperative and complementary manner with that of other international institutions, among them the World Trade Organization *vis-à-vis* which steps have already been taken to demonstrate our willingness to work in tandem on issues of mutual interest. The first opportunity to put this goal into practice will be the contribution UNCTAD IX has been asked to make to the Singapore WTO Ministerial Conference, in accordance with the United Nations General Assembly resolution of 8 December 1995.

345. In order to complement the agenda of negotiations, the second line of UNCTAD's activities should be directed at helping countries to implement the results thereof. The goals here would be to make the best possible use of opportunities created in trade (working through the programmes of trade efficiency, TRAINFORTRADE and ASYCUDA, among others); to promote investment (through a possible multilateral framework, individual country profiles, etc.); to provide technical assistance to governments interested in designing competition laws; to advance positive incentives for environmentally friendly development; to conduct reviews of national policies on science and technology; and so on.

346. This pragmatic approach will find one of its most telling expressions in the programme for technical cooperation on promoting trade for African countries after the Uruguay Round, put together and to be jointly implemented by UNCTAD, WTO and ITC.

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347. The future work of UNCTAD will be a topic of intense intergovernmental discussion during the preparations for UNCTAD IX and at the Conference itself. The provisional agenda for UNCTAD IX offers important indications for the direction of UNCTAD's future work. In pursuing such discussions, attention should be given to the following considerations:

(*a*) There is need for fundamental change in the manner in which UNCTAD goes about fulfilling its mandate in trade and development.

(*b*) UNCTAD's activities need to be more sharply focused on a relatively small number of issues of central importance to development on which it can make a substantial impact.

(*c*) While recognizing fully the common elements of the development experience, the work of UNCTAD needs increasingly to take account of the present diversity of development situations and problems. In considering such diversity, the distinction between those developing countries requiring assistance primarily in securing access to globalizing markets and those countries requiring assistance primarily in creating and expanding capacities to supply goods to those markets is of particular importance.

(*d*) UNCTAD will need to keep under review the evolving phenomena of globalization and interdependence, and to assess broad development issues against this background. It will also need to assess the implications for development of the evolution of the systems governing international transactions and seek to promote an evolution of those systems that is "development friendly". Consensus-building is a concept of particular importance to such activities.

(*e*) UNCTAD should intensify its concrete activities having a direct impact on national economies, particularly in the areas of trade, investment and enterprise development. These activities include, but are not restricted to, technical cooperation.

(*f*) The intergovernmental machinery of UNCTAD needs to be tightly structured, yet sufficiently flexible to accommodate a wider range of intergovernmental interaction than in the past. It is important that each type of intergovernmental forum engage only in those activities for which it has been designed. The initial stages of intergovernmental deliberations will need to be expertized.

348. The Secretary-General is of course keenly aware that UNCTAD's resources are limited, and that it will only be able to make a modest contribution to the achievement of the goals outlined above. It is in fact doubtful whether any organization or country acting alone would be able to attain those objectives because the problem goes well beyond the question of resources. For one of the major new developments in international relations in these closing years of the twentieth century has been the emergence of a range of non-governmental actors that exert a growing influence on world affairs. Transnational companies, both large and small, private investors, non-governmental organizations, universities and research centres—sometimes working alongside governments, sometimes working independ-

ently and at times more effectively than governments—are leaving their mark on the shape of things to come.

349. By and large, multilateral institutions have so far failed to give these new actors adequate room to express themselves and to make their weight felt. This oversight is all the more surprising when we remember that, as early as 1919, in the aftermath of the First World War, the statesmen and diplomats gathered in Versailles showed a remarkable openness in accepting a revolutionary innovation: the tripartite structure of the International Labour Organisation, with the right to deliberate and to vote accorded to the representatives of the workers and the employers, alongside those of governments. Obviously the rationale in this case was that one could not, and ought not, to decide on labour matters without the direct participation of those concerned. If this is so, a case could likewise be made in favour of providing, in economic discussions, a space for the participation of those individuals—producers and consumers alike—who will put into practice the decisions on production and consumption formally arrived at by governments.

350. This is admittedly an extremely complex and difficult subject, on which simplistic solutions will not do. Its far-reaching implications will develop only with time. Nevertheless, it is to be hoped that in the near future we shall be far-sighted enough to begin the integration of the private sector and of other new actors into our daily operations. By acting along these lines, we could help to convert a conference into a real partnership for development, making UNCTAD a model of what a truly international agency of the twenty-first century should be.

351. Is this all too much of a challenge for UNCTAD IX in just a few months from now? We do not believe so. After all, South Africa, where we shall have the privilege to meet, has in recent times performed an infinitely more daunting task. If we have nothing to teach our hosts, we certainly have much to learn from them. We can draw inspiration, in particular, from the exemplary way in which South Africans have been able to overcome an almost bottomless abyss of hatred and prejudice, and are now engaged in attempting to bridge the socio-economic gap that still separates the different sectors of their community. Compared with what was long considered one of the most intractable problems of this century, the tasks ahead of us do not appear to be beyond our reach.

352. We have already started the process of redefining UNCTAD's *objective* in terms of a few clear and central priorities. Our recent intergovernmental consultations showed a significant degree of consensus on the need to reduce and simplify the number of intergovernmental bodies and the frequency of meetings, so as to increase the efficiency of our *method* for interaction and work. Improvements in the cost-efficiency and performance of

the secretariat will both prepare for and facilitate the implementation of these two aspects, serving as the *instrument* for the reform process of UNCTAD.

353. We should never lose sight of the fact, however, that the only justification for UNCTAD's regeneration and its sole claim for continued existence is its ability to make a relevant contribution to the tasks of fostering growth, reducing inequality, and building its capacity to make a difference to people's lives. This has to be especially true in the case of those who need UNCTAD most, the least developed countries—so many of which are in Africa—where our Conference has a duty to offer them concrete and effective solutions to their problems.

354. If it is true that each society will be measured by the way it treats its more vulnerable members, then the international community in general, and UNCTAD in particular, will ultimately be judged according to the attention that they pay to Africa and to the least developed countries as a whole. This is the central problem, the major challenge of the *fin de siècle*. It will no doubt be with us still at the beginning of the next century and on into the third millennium, as a doleful legacy. It is an old, indeed a very old problem, for nothing in mankind's history is older than poverty and deprivation. But the circumstances of the problem are new. For while globalization renders deprivation intolerable, it may for the first time show that the problem is mature for a lasting solution. Moreover, globalization makes the problem inescapably that of all of us. We cannot shirk our responsibility. We must hope therefore that the benefits from a global economy will more than match its costs and that the net balance will be enough to eradicate poverty and human under-development.

355. We shall have at hand in South Africa and beyond the possibility of starting to redirect these powerful forces to that end provided that we are able to build confidence and consensus in the renewed spirit, approach and language required by the new times. For, as T.S. Eliot wrote, "Last year's words belong to last year's language. And next year's words await another voice."

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